

**FOURTH
INTERNATIONAL CONGRESS
ON ACCOUNTING
1933**

**Held in London on the
17th, 18th, 19th, 20th & 21st July, 1933**

**HEADQUARTERS
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FOREWORD

The suggestion of an International Congress on Accounting being held in Great Britain was first mentioned at the Second International Congress in Amsterdam in 1926, and the hope was then expressed that it might take place in about three years time. But as the Jubilee of the Institute of Chartered Accountants in England and Wales would be celebrated in 1930 it was felt that the two events could not be observed without a reasonable interval elapsing, and the Third International Congress on the invitation of organised bodies in the United States was, therefore, held in New York in September 1929.

Before leaving London to take part in that Congress, Lord Plender (then Sir William Plender, Bt.), and the other delegates of the Institute of Chartered Accountants in England and Wales, were instructed by the Council of the Institute that if a general desire was manifested that the next International Congress should be held in Great Britain, such a suggestion would receive the most cordial sympathy and support of the Institute.

The delegates of the Society of Incorporated Accountants and Auditors and of the Scottish and Irish Institutes of Chartered Accountants assured Lord Plender of the cordial support of their respective bodies. This message Lord Plender communicated to a Sessional Meeting in New York and it was received with acclamation. He concluded his speech with the words : " While there will not be undue haste in convening that Congress, there will not be, I assure you, undue delay."

Such was the origin of the Fourth International Congress on Accounting, which entered its initial stage at a meeting of representatives of the Chartered Institutes and Societies of Great Britain

and Ireland and of the Society of Incorporated Accountants and Auditors, held at the Institute of Chartered Accountants, Moorgate Place, London, E.C.2, on Thursday, the 30th April 1931. It was then resolved that the Congress be held in London during the month of July 1933, and that invitations be extended to the London Association of Accountants and the Corporation of Accountants to assist in acting as hosts. The composition of the Executive Committee was fixed, the Secretariat appointed, and the principles of finance and organisation arranged.

It was decided to limit the number of Papers to twelve, and that they should be printed in English only ; it was further determined that they should not be read at the Sessions, but circulated in advance and introduced briefly by the authors, thus allowing ample time for discussion by delegates and visitors from abroad, as well as by members of the Sponsoring Bodies. French and German interpreters were present at the Sessions and arrangements were made that someone should always be in attendance in the Secretariat office who understood those languages. The Committee venture to express the hope, indeed the conviction, that the foreign visitors found adequate opportunities of self-expression, and that no inconvenience was caused through the limitation of the languages spoken.

Forty-nine Societies accepted invitations to the Congress, appointing 90 delegates, and in addition 79 visitors from abroad attended. Many of the delegates and visitors were accompanied by their wives. In all, 22 countries were represented. Many of the foreign visitors extended their stay in Great Britain by visits to Scotland and Ireland, accounts of which will be found recorded in this book.

The headquarters of the Congress were at Grosvenor House, Park Lane, London, W.1. The Address of Welcome, the Reception, the Ball and all the Congress Sessions took place in the Skating Rink. An office was opened in the Mount Suite on 10th July, and the Ballroom was used each day for the entertainment at luncheon of delegates, visitors and their wives.

The Executive Committee wish to thank most sincerely all those

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who co-operated in the work of the Congress, particularly those friends from abroad who read papers, opened and took part in the discussions, and acted as Chairmen and Honorary Chairmen at Sessional Meetings. Their thanks are also cordially extended to all other overseas visitors who attended the Congress, as well as to those members of the Institutes and Societies at home, who by their interest and help made the Congress so great a success.

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PROCEEDINGS
OF THE
FOURTH
INTERNATIONAL CONGRESS
ON ACCOUNTING

MONDAY, 17th JULY, 1933

SERVICE IN WESTMINSTER ABBEY

The proceedings of the Congress were opened by a service in Westminster Abbey, for which the Dean of Westminster, the Very Rev. W. Foxley Norris, C.V.O., kindly gave his permission. The Dean officiated at the service, and His Grace the Archbishop of York preached the sermon.

Provision was made for the attendance of over a thousand people at the service, and about two hundred tickets were issued to foreign visitors. The service ended at 11.45 a.m., and parties of foreign visitors were then escorted over the Abbey by official guides.

(For the Order of Service see Appendix A.)

The Archbishop took as his text the words "Seek ye first the Kingdom of God and his righteousness"—or his justice—"and all these things shall be added unto you." (Matthew 6, verse 33.) The words "these things," said the Archbishop, referred to "what we shall eat" and "what we shall drink" and "wherewithal we shall be clothed." In other words, the distribution of economic goods would come right when men sought first the Kingdom of God and His justice.

How insistently history taught us that lesson; and how continuously mankind disregarded it! We liked to take to ourselves what was sometimes called the consolation of religion—to seek in it a comfort for our distress without trying to understand or to remove the causes of our distress. But the proclamation that God was love was not only an announcement of a truth which brought comfort to everyone whose heart was touched by the spirit of love, but was also and inevitably the proclamation of judgment upon all policies or purposes which were dictated by motives at variance with love. For if God, the Supreme Reality, was love, then every policy and purpose which was governed by selfishness was based upon something at variance with ultimate reality, and was bound to end in calamity. So our Lord said that they who heard His sayings and followed them were like those who built upon a rock—the rock of fact—while those who heard them and followed them not, built

their house indeed, the house in which they sought for these consolations of religion, but when the time of stress came the house would fall because it was not based upon fact, which alone supplied firm foundation.

This thought of the working of the Divine judgment upon all that was contrary to the Divine will was very prominent in the Gospel. Our Lord wrapped up what He had to say concerning His own judgment of the world with what He foresaw to be an imminent event in the experience of the disciples—the fall of Jerusalem. It fell because it could not rise to the height of its spiritual opportunity; it did not know the time of its visitation.

It was not, of course, that Christ, when foretelling the destruction of Jerusalem, turned in petulant irritation upon the city which had offended Him by refusing to receive Him and do Him honour; it was that he knew that the cause of its failure to receive Him was the cause which inevitably would bring upon it the punishing armies of Imperial Rome. In their ambitious worldly nationalism they would become a nuisance to that power which was not tolerant of nuisances, and the blindness which led them to reject Him and His gospel would be the cause of their fall. When Jerusalem fell the Son of Man came into power and later when the Roman Empire fell—largely, at least, because it was based in those latter days upon vast organisations of slave labour, which was a denial of the principles of the gospel—the Son of Man came in His power. And when the medieval world broke up, because the Church itself had become infected with worldliness, the Son of Man came in His power. Again, when Europe went over the brink into ruin in 1914, because its self-centred nationalism left no room for an adequate consideration of the common good among all peoples, the Son of Man came in His power. So through history He asserted the supremacy of love by the judgment which all purposes and policies alien from love brought upon themselves.

The writer of the great book with which the Bible closed beheld all history as it were set out in a single panorama, and its leading principles were two: the principle of self-centredness and pride, which used force as its instrument and was typified by the great wild beast, and the principle of love, which used sacrifice as its instrument and was typified by the Lamb as it had been slain. Over and over again men had built upon the basis of self and pride, by means of force, the civilisation whose name in that book was Babylon the Great; and every time it came tumbling down because it rested on a foundation that was not the rule of God. But ever before men's eyes was the vision of that civilisation which

could be the Holy City, which came, when and in whatsoever degree it came, always from one source—out of Heaven, from God.

In the history of our world these two were ever mingled with each other. There was much about the ordering of our life which showed that in part it was based upon self and pride and acquisitiveness, with the force that these must exercise to gain their ends. But there was also much—and, broadly speaking, in every century there was more—which showed that it also rested upon the desire for mutual service and a realisation that the good of the part could only be found in the welfare of the whole ; and progress consisted in the increasing predominance of this principle over the other.

When we turned to apply such thoughts to the routine of our material and economic life, two things above all were seen to be involved as necessary. The first was obedience to God and the realisation of dependence upon Him, and the second was mutual trust among those who conducted the world's affairs, in little things and in great.

But trust and trustworthiness went hand in hand. It was not true simply that one of them created the other, but that each created the other. When a person was trusted, he did not like to betray that trust, and so found an added motive to be trustworthy. And when a person was trustworthy he encouraged others to trust him—for the first time if they had not yet done it, in greater measure if they had. Trust and trustworthiness developed one another in the world, and those who were gathered in the Abbey that morning were, in a quite peculiar degree, the custodians of that sacred principle of trustworthiness and trust.

Upon their profession, and the conduct of its responsibilities by its members, must very largely depend the basis of mutual confidence which was the first condition of returning or abiding prosperity. It was because they knew that full well that they had come to the Abbey, in order that in the course of their deliberations, and at their very outset, they might remember that other great factor which was the primary necessity of man's welfare—the sense of dependence upon God for guidance and for power. Surely the very holding of that Service was of good augury, not only for their Conference but for the future of the world. For they, upon whom so much depended in those various countries which they represented, had come to seek the guidance of God and to confess their dependence upon Him in their work of maintaining among those who conducted the world's business mutual confidence and trust.

Upon such a purpose they knew that the Divine Blessing fully rested.

With the sense of such a consecration about them they would proceed to their deliberations with the confidence that they could claim God's guidance. And those who watched would try to pray with them and for them, that through them something more might be done to bring mankind to lay aside the dreams of acquisitiveness and to seek first God's Kingdom and His justice.

OPENING SESSION

PRESIDENTIAL ADDRESS

An audience of some seven hundred people assembled in the Skating Rink, Grosvenor House.

THE PRESIDENT, who was warmly received, said : My Lord, ladies and gentlemen, before I formally open the proceedings Mr. Colville has some messages of goodwill to read to you and some announcements to make.

THE SECRETARY : The first telegram I have is from Egyetemet Végzett Revizorok Országos Egyesülete (Hungary) and reads as follows : "Sorry to be absent. Wish successful work."

From Calcutta : "Society of Chartered Accountants in India sends greetings to the Fourth International Congress on Accounting and wishes them success in their deliberations."

"Dear Sir, I am sending you my best wishes for the fruitful results of the debates the purpose of which is to solve the problem of regulating and controlling the economical life of industry—Antoni Szyller, President of the Association of Experts of Accounting and Accountants in the Polish Republic."

"New Zealand Society of Accountants sends greetings to delegates and wishes the Congress a profitable and enjoyable session—George Reid, President."

"Regret prevented from attending Congress, best wishes—Doctor Schourp (Essen)."

"Cordial greetings and all good wishes for wholly successful Congress—American Institute of Accountants."

"The Association of Accountants and Auditors in Ontario extends cordial greetings, and best wishes for a successful Conference—S. W. Eakins, President."

"Regret detention owing important professional engagement and offer fraternal greetings from Indian Accountancy Profession—Sodhbans, Editor Indian Accountant."

"To Lord Plender with best wishes for a successful Congress—

Glover and Couchman send kind personal regards to you and other friends and regret keenly their inability to be present."

From Deloitte, Johannesburg : " Heartiest good wishes for success of Conference."

THE PRESIDENT: My Lord, ladies and gentlemen, twenty-nine years have passed since the first International Congress on Accounting was held in St. Louis, United States of America. A period of 22 years elapsed before the second Congress took place in Amsterdam in 1926 and this was followed three years later in 1929 when the third Congress was held in New York. After four years the Congress now meets in the capital City of the British Empire, and it affords the members of the profession in Great Britain and Ireland an opportunity—which we warmly welcome—of renewing friendships and making new friends with our professional brethren from overseas. (Applause.) We recall with great pleasure the courtesy and hospitality extended to us at previous Congresses ; we are appreciative of the acceptance of our invitations by so many delegates from abroad, and it is our earnest hope that this Congress may strengthen the cordial relations which exist between the organised bodies of practising accountants throughout the world. (Hear, hear.)

The number of appointed delegates and the members of accounting bodies attending each of the Congresses and the size and contents of the volumes which record the proceedings demonstrate the interest of the accountancy profession in such gatherings. The volume of the St. Louis Congress contains 220 pages, that of Amsterdam 850 pages and the New York volume 1,376 pages. Whilst it may be found that the book which will be published as a record of the proceedings at this Congress will not compete in size with the last two volumes, yet it may be not less helpful, as the subjects selected for addresses and discussions cover a comprehensive field. It may be said that some of the addresses are of special interest to the profession in this country, but we believe they will also prove to be of real value to those present from other countries. We have been fortunate in securing the co-operation of eminent accountants both in Great Britain and from abroad in uniting to give us the benefit of their views on the subjects selected, and there will be, I hope, ample opportunity for useful discussion. The period available for the Congress did not permit of any enlargement of the business programme without curtailing the time which should be devoted to the consideration of the papers and at the same time give some reasonable relaxation by way of visits to places of historic interest.

It would be inappropriate for me in this address of welcome to anticipate the proceedings of the Congress ; but it may not be out of place if at this stage I address to you, *inter alia*, a few general observations upon certain ethical principles and aspects of professional duties and obligations which should have universal application.

Accounting as an organised profession is of comparatively recent growth and originated in Great Britain. Yet within a few decades it has increasingly established itself throughout the world in the estimation and confidence of governmental departments and municipalities and public authorities and of the business community and the investing public.

We owe much to the wisdom and foresight of the pioneers of the profession who founded it upon a code of ethics adherence to which has in no small measure contributed to the position we occupy to-day, and it is well on an occasion like this that we should pay a tribute to their memory. (Applause.)

Mutual esteem and respect between our members must be based, not only upon the professional ability we show and the reputation we enjoy individually, but also upon the maintenance, under the aegis of our respective organisations, of a high standard of professional rectitude. The vast public whom we serve as clients form their judgment of the professional status of accountants from their contact with our members, and it is the character of the individual members which alone can uphold the traditions and prestige of the bodies to which we each belong. It is the province of our respective organisations by whatever name they may be called, to preserve by examinations a high level of professional knowledge and training essential to secure admission to membership, and also to ensure, as far as disciplinary action can do, that no member by his acts or omissions shall escape the consequences of conduct which would bring him, and through him the profession, into disrepute. (Applause.)

But apart from these fundamental duties which devolve upon those members who constitute the executives of our respective organisations, it should be the personal obligation and privilege of all practising accountants to initiate and encourage frequent intercourse with one another for discussion and exchange of views as a means of increasing our own usefulness, of enhancing the reputation of the bodies to which we belong, and of making the profession as a whole more helpful to the community. And particularly do such personal contacts foster the spirit of right conduct between practising accountants themselves.

Unofficial committees or panels having no official connection with the

governing bodies, exist in various important business centres or districts. Any practising accountant who finds himself in a position of doubt or difficulty concerning a professional matter can consult confidentially the members of such a committee who are frequently in a position to give him most helpful advice. The value of such advice, especially to a young accountant whose experience is necessarily limited, can well be appreciated.

The accountancy problems to be considered at the Congress cover a wide area, and the application of the principles involved is in many respects international. But it must be remembered that the laws of countries differ in regard to the books of account to be kept ; judicial dicta vary as to the responsibility of directors and of auditors respectively ; form or architecture in the compilation of balance sheets and profit and loss accounts differs ; the functions of auditors and the scope of their duties do not always bear a resemblance in countries with different conceptions of what is required of auditors, and to expect international uniformity in all these respects is impracticable. Notwithstanding these differing conditions, there would, I think, be agreement that the goal of attainment everywhere lies in clearly stating material facts in balance sheets and profit and loss accounts, and the subject will be fully ventilated at the Congress.

Another matter of international interest is that of holding companies, and the treatment of profits and losses of subsidiary companies. The rapid growth in comparatively recent years of this movement, particularly in this country and in the United States of America, gives rise to accounting problems and principles of great importance, and they will form during the Congress a subject of fruitful deliberation. There are other papers relating to exchange fluctuations, depreciation and obsolescence, finance, public utility undertakings, &c., that also have international characteristics. We hope that all the papers will provoke the comments of delegates and visitors, and lead by mutual exchange of views to clear understanding and a considerable measure of accord in the fundamental principles to be followed in the treatment and preparation of accounts. But no resolutions will be submitted to the Congress affirming any particular views as recommendations for the profession as a whole.

I have alluded to the benefits available to members of the accountancy profession in this country in being able to consult unofficial committees in regard to professional matters, and I have also referred to the benefits which we all hope to obtain at and from this Congress by the exchange of experience and views and by a study of the valuable papers which are to be submitted. These considerations lead me to wonder whether any means

could be devised of pooling knowledge of the practice which obtains in various countries where accountancy has become organised. It may be said that subjects of international interest have already been dealt with very fully in addresses and books which are available to the diligent seeker. But they are widely scattered and are not accessible to accountants in all countries, and not too readily found even in the country of their origin. What is wanted is to bring together in concise and clear form essential material information concerning the relevant law and accountancy practice in each country as affecting matters of common interest to the profession throughout the world and to keep such information revised to date so that it embodies new legislation, recent decisions of the Courts and the latest experience. Volumes so compiled would form a compendium of universal interest and be of great value to practitioners in each country.

Our profession grows in importance year by year. In the complexities of modern business there are hardly any directions in which our experience and advice may not be of value in connection with financial policy, the form and presentation of accounts, or in relation to effective methods of record, control and organisation. Government departments constantly seek our advice and assistance on matters with which we are specially qualified to deal. Investors are influenced by our certificates in prospectuses offering securities for subscription. Shareholders in public companies look to us to watch their interests as far as it is within our power to do so. We are not guarantors or insurers in connection with accounts which we examine and report upon and we are not infallible ; but if we are honest with ourselves and not afraid of expressing our opinions after careful and thorough inquiry, and with sound and well-balanced judgment, we shall serve our clients faithfully and maintain the prestige of our profession. (Applause.) And whilst the discovery and proper statement of facts should be our aim, we cannot neglect vision in our outlook and service.

As national prosperity increases—which is in no small measure affected by international trade—so does accountancy flourish. Any influences which contract business are not to our advantage, and we in common with all sections of the community earnestly desire to see a restoration of healthy and sustained activity in commercial and industrial enterprise. (Hear, hear.) But the people of all nations are suffering from high taxation, and as a consequence, industry is crippled and developments retarded ; budgets are unbalanced ; free interchange of commodities is impeded by high tariff barriers ; unstable exchanges make trading between many countries almost impossible ; government subsidies to support

commercial ventures that compete internationally give unfair advantages to those so assisted, and anything approaching uniformity in world policy on these and other cognate questions seems at present incapable of attainment. Extreme nationalism which is the equivalent of isolation does not help the world in the crisis which confronts it, and it may be found that such a policy will not prove to be of ultimate good to the nations adopting it (Applause.) Still there is no reason to despair. Though difficulties, which are common to all nations, do not seem capable of solution by one great effort, yet arrangements made between groups of nations for their mutual advantage may pave the way to something more comprehensive.

There are some Congresses or Conferences which do not in achievement fulfil the expectations of their conveners. That will not be the fate of this Congress ; we shall gather wisdom from the past, learn new truths from the present, discuss principles which are universal in their application, and with hope press forward—always striving, seeking and finding.

On behalf of the sponsoring bodies who are your hosts, I express, in conclusion, the hope and belief that when this Congress is over you will carry to your homes in far off lands the happiest recollections and the good wishes of your many friends here. (Loud applause.)

THE VICE-PRESIDENT: My Lord President, my Lord, ladies and gentlemen, I feel sure that your Executive Committee will accurately interpret your wishes when through me they call upon representative delegates of each of the overseas countries to address you for a brief period. I have on my list the names of 17 countries, and I will now ask representatives of each of those countries to come on to the platform and briefly to respond to the Address of Welcome which has been delivered by our President, Lord Plender. The first country on my list is Africa. I have met one of the delegates but, unfortunately, he told me that he was not going to speak, so I will now ask a delegate whose name is not on the list to come to the platform and respond on behalf of Africa—Mr. J. G. Carter, A.C.A., F.S.A.A., of Johannesburg.

MR. J. G. CARTER (Johannesburg): My Lord, ladies and gentlemen, I am not an official delegate from Africa ; I am a humble representative from the southern portion of that Continent. Coming from there I would like to express my great appreciation of the remarks which Lord Plender has made this afternoon. I think that those remarks give us great food for thought and that the papers, and the discussions which are going to take place during the next few days, will enable us to give expression to it. One thing has struck me very much, and that is the admirable way in which

the preparations for this Congress have been made. I think that those responsible for the arrangements are very much to be congratulated, and in view of what we have seen and what has happened already I look forward with great pleasure to the further proceedings of the week, not only to the serious business of the Congress but to the entertainment which is to be so lavishly provided. In view of the long list of gentlemen who have to reply I will simply thank Lord Plender for his address and leave it to somebody else to say more.

HERR DR. W. VOSS (Germany): My Lord President, on behalf of the German Institute of Wirtschaftsprüfer and of other general organisations of accountants, I have the honour to bring you our best wishes and our cordial congratulations for this Congress. We all know that the standing of the profession in Great Britain is very, very high indeed, and the fact that this Congress is organised by the British Accountants is the best guarantee for its good progress. I would not like to take up too much of your time, therefore I shall express only one more wish. As accountants we have to deal not only with accounts and figures but with what is behind those figures—I mean the economic life—and as auditors we know not only the theoretical but the practical difficulties of that life. I think that we, as practising auditors, on many occasions see more than we like to see of the illness of that economic life in these days. I am sure that you will agree that it is our duty as practising accountants, and especially as auditors, to do our best for the reconstruction of that economic life all over the world. That this Congress may be a great step forward towards that goal is our wish and our hope. I thank you very much. (Applause.)

MR. JOHN F. FORBES, C.P.A. (United States of America): Lord Plender, delegates and visitors, I am desired by the members of the American Institute of Accountants, the American Society of Certified Public Accountants, and the American Association of University Instructors in Accounting, the National Association of Cost Accountants, and the several State and Territorial Societies to whom invitations have been sent to attend the Congress, to extend their greetings to the officers and delegates of the Fourth International Congress on Accounting, and to express some measure of their feeling of obligation to those who have assumed the very great and onerous responsibility of organising and assembling this Congress. Members regret that time and distance, as well as some even more insuperable causes, have made the number of their delegates smaller than they would desire, but I may assure you that

the proceedings of the Congress will be reviewed by them with every interest.

Members of these organisations wish the Congress every measure of success. Thank you !

THE VICE-PRESIDENT: Ladies and gentlemen, there is another gap, due to the modesty of the nations which compose the British Empire. We have no delegate on our list from Australia. Would someone kindly respond to Lord Plender's welcome on behalf of Australia ?

MR. WILL APPLETON, F.R.A.N.Z. (New Zealand): Lord Plender, ladies and gentlemen, I do not happen to come from Australia, although I have business interests there. I come from a little country called New Zealand, and with my fellow delegates from other parts of the world I wish first of all to thank the sponsors for the way in which they have welcomed us to Great Britain. It is always a great pleasure, of course, for a New Zealander to come home—because to us this is home—but I am doubly honoured at this Congress to be able to speak on behalf of Australia. We are a small Dominion. Australia is a vast continent. In regard to accountancy, Australia has made great progress during the last 20 or 30 years. In the first place, we were fortunate in having many members of the Chartered Institute and other accountancy organisations in England who started various bodies in the Commonwealth. During the last few years they have got a Charter, and the accountants of Australia to-day are practically one united body. New Zealand has been more fortunate still, inasmuch as we have the New Zealand Society of Accountants, which was successful in getting an Act of Parliament passed, and in New Zealand we have to-day one united body of accountants for the whole Dominion. (Applause.) We have a membership of roughly 2,000. Some of the older bodies, the Institute and the Auditors' Association, are still in existence, but merely with the idea of seeing that the baby makes proper progress. (Laughter.) The baby has now been in existence for over 20 years, so it has become a very live infant. I will not detain you now ; I am very, very glad to be here to represent both Australia and New Zealand, and I wish to thank you most sincerely on behalf of those two countries. I am sure that this Conference will be even a greater success than the previous ones, and I and my colleagues hope to have some opportunity of meeting other members from various parts of the world. After all, it is not so much the fact of meeting here ; we must remember that a Congress of this kind is going to have its effect the world over. We in New Zealand are intensely interested in what is going to happen at this Congress and I know that

accountants in other parts of the world are equally interested. I thank you.

HERR KAMMERRAT SPOHN (Austria): My Lord President, ladies and gentlemen, as the representative of the Austrian Accountants I have the honour of attending this Congress and I first of all thank you for your kind invitation. I am charged to bring you the greetings of your Austrian colleagues and their best wishes for the success of the Congress. If I am allowed to comment upon the position of the accountants in Austria I must state, first of all, that the system of controlling is, on the whole, theoretically and practically perfectly up to date; the vocation itself, however, is not yet legally settled, and this in spite of our endeavouring for years to attain this aim. The Gremium der Buchsachverständigen in the name of which I am appearing here, can be regarded as representing the idea of auditing in Austria. In the year 1904, at the time of the foundation of our Gremium, there was no accountant in Austria who had taken up this profession for a living; there were only accountants attached to the law courts; the private undertakings used bank clerks or other book-keepers who spent their free time auditing. To-day the number of the accountants in Austria amounts almost to 1,000, of which nearly one-third regard this profession as their main one. The conditions in England, the classic country of accounting, always served as a model to our Gremium, which wholly adopted the organisation of the Institute of Chartered Accountants. From this, as from all international Congresses we expect, besides becoming mutually acquainted, that our profession, which is so important for the welfare and prosperity of all states, should gain the due consideration of the public and the competent Government Departments. Once more I express my best wishes for the success of the session of the Congress in 1933.

MR. JOHN HYDE, F.S.A.A., C.A. (Montreal): My Lord, ladies and gentlemen, I have to thank my colleague, the official representative for the whole of Canada, for giving me the honour of addressing you to-day. Probably he has recognised that my grey hairs represent one of the bodies of Canadian Accountants—that is the Society of Chartered Accountants of the Province of Quebec—which I think is the third oldest professional accountancy body in the British Empire.

Sir, on behalf of Canada, I have to thank you for the address which you have given us to-day. Certainly, in opening this Congress, you have placed before us a programme which it will take the best of us to follow through. (Hear, hear and laughter.) I regard this Congress as one that is

going to be of great value to every professional accountant throughout the world. I thank you.

HERR. J. P. STROBEL (Denmark) : Mr. President, ladies and gentlemen, on behalf of the Association of State-Authorised Auditors in Denmark I have the honour and pleasure to bring a greeting and hearty thanks to our English colleagues because they have been willing to take upon themselves the great trouble which is connected with such a Conference as this. Denmark was one of the first countries where the arrangements of accountancy conditions were taken up as a State problem. In Denmark it is necessary to go through a special education and experience, and take special examinations before appointment can be obtained. The appointment is given by the Ministry of Commerce, and at the present time we have 152 of these State-Authorised Auditors practising in Denmark. According to the Danish law it gives the State-authorised auditors the authority to declare the correctness and validity of any accounting matters, legal proceedings, &c., before the Court. Some of the Danish laws, for example the Companies Act and Banking Law, contain decisions that State-authorised auditors must be employed, and others, for example the bankruptcy law, that these auditors shall have preference. During the preparation of the very first arrangements for the accountancy authority in Denmark, the English accountancy conditions were used as prototype. We have also continually had the English accountancy authority in view during the further development of the Danish accountancy, both in respect to examination demands as well as the purely practical conditions. The fact that the Danish State-authorised auditors have been able to fulfil those demands which not only the Danish authorities but also the business life in the course of time have made upon them, is, in my opinion, considerably due to the fact that we have taken the development and the conditions in England as our model and that we also had in view the making of similar demands concerning our examinations as are demanded by the very severe English accountancy examinations. It has therefore been a great pleasure for my Danish colleagues here and myself to be able to accept the invitation of our English colleagues to this Congress, which we have looked forward to with great interest and anticipation. The excellent manner in which the Congress has been arranged, together with the very interesting subjects which have been taken for discussion and treatment at the Congress, have exceeded our most sanguine expectations, and we feel convinced that not alone we Danish accountants will obtain great professional benefit from this Congress but that it will also be a great step

forward towards enhancing internationally the competency and reputation of the practitioners in the business of accountancy.

MONS. M. BARBUT (France), speaking in French, said : In the name of the Délégation Française d'Experts-Comptables who are participating in this International Congress of Accounting, I have the honour and the pleasure to thank the President for the words of welcome which he has addressed to his foreign guests. We are very sensible of the welcome, full of cordiality and of good will, which has been shown to us in this country of Great Britain where men of our profession have been able, by their individual merit and their exemplary collective organisation, to take a place so enviable and legitimate in the economic world. This morning we had before our eyes, and it touched us to the bottom of our hearts, striking evidence of their very high prestige in the magnificent ceremony which we had the privilege of witnessing at Westminster Abbey where we bowed with emotion before your great men.

We desire also to express to the organisers of this Congress and in particular to its very distinguished Secretary, Mr. Colville, our recognition of the care and zeal which they have shown in its preparation, also our congratulations on the quality of the methodical programme which they have prepared and the choice of questions which are offered for our deliberation.

We would also like to congratulate the authors of the substantial papers which will serve as a basis for our discussions.

The questions appearing on our daily programmes are of such importance and extent that they include matter essential to our professional work. In order to examine them we will be able to utilise our usual instruments, which are analysis and criticism. May I be permitted to add that we will try unanimously to imitate the qualities of an English Prime Minister who was taken, unfortunately, all too soon from the service of his country, Mr. Bonar Law, who held that a good head and clear ideas were most necessary to men for the success of their undertakings—a good head in the sense that our principal moralist of France, Michel de Montaigne, understood when he affirmed “ Mieux vaut tête bien faite que tête pleine.”

In conclusion, I formulate the wish which I have no doubt will be accomplished that this Congress of men who are met together to discover the truth and to express it always with loyalty will constitute a model of collaboration and of international discussion. The more we meet, the better we understand one another and the better we appreciate one another, Such has been our objective in accepting your gracious invitation

COMM. DOTT. A. SELVI (Italy) : Mr. President and colleagues, in the

name of the Honourable Mr. Baccarini, secretary of our National Fascisti Federation of Certified Accountants, and in the name of all our associated colleagues, I thank our Honourable President for his courteous invitation to participate in this important Congress, so well organised, and also for the cordial reception. Although this Congress is purely technical in character we wish to express our fervent hope that at the re-opening of the World Economic Conference it may be possible to reach the solution desired by all and in the interest of all. This Congress, and all similar ones, besides giving scope for interchange of ideas on purely professional subjects, theoretical and practical, should have also a most important complementary function—that is to give an opportunity to business men of all nations in their daily contact with one another and in this favourable atmosphere to arrive at a reciprocal comprehension and understanding of the vital needs and interests of the nations here represented. In this way each individual on his return home may carry on the good work of propaganda in his own country. We of Italy have never more deeply than at the present time felt the importance of our profession inasmuch as in a corporate State each one is called upon to labour not for the individual but for the national interests and welfare. I will close this brief address with the fervid request to our fellow congressmen to agree that our next Congress should be held in Rome. I therefore hope to meet you all again in 1935 in my own country, where each one will have the opportunity to appreciate for himself the stimulating effect which the leadership of our Duce has had upon an entire people. (Applause.)

DR. K. FUJIMOTO (Japan): My Lord President, ladies and gentlemen, allow me, as a delegate of the Japan Accounting Society, to express my hearty thanks for the kind invitation to the International Congress on Accounting. I am very glad to avail myself of this very good opportunity to make acquaintance with those noted leaders and experts on accounting and other gentlemen in your Kingdom, as well as those persons visiting the Congress from different countries in the world. I thank you again for the kind invitation and I wish the Congress great success.

SEÑOR R. CASAS-ALATRISTE (Mexico): My Lord, ladies and gentlemen, the Mexican Institute of Accountants, over which I have the honour to preside, made all possible efforts to send a delegation to this Congress as it had done in regard to the third Congress in New York. That is a proof that Mexican accountants want to be entirely in contact with the elements of our profession and will take their share in the responsibilities of rebuilding the world. Although Mexico is a small country and so far

away, she has proved her interest in this Congress by the sending of this delegation. (Applause.) We are very much concerned that, owing to the business difficulties of the times, we have not been able to prepare a paper regarding the developments of the profession in Mexico and the problems that the Mexican accountants are trying to solve, as are the accountants in all other countries, but I wish, in the name of Mexico, to express our deep sense of gratitude to the accountants of the British Empire for this opportunity which has been afforded to us of meeting in Congress and I tender to you our best wishes and hope that this Congress will prove a success and will be a great help in the reorganisation of the economic conditions of the world. Thank you.

HERR CHRISTIAN SOMMERSCHILD (Norway): My Lord President, on behalf of the Norwegian Associations of Accountants and Auditors who are represented at the Congress—that is to say the Accountants' and Auditors' Association of Bergen, the Association of Bourse Authorised Accountants and Auditors, Oslo, and the Norwegian Association of State Authorised Accountants—it devolves upon me to convey to the hosts of the Congress and to its leaders our humble and hearty greetings. From the earliest times of which we have historical record Norwegians have been a nation of seafarers. Our ancestors adventured in their open boats across the wide seas towards the west. In those days the Vikings were no welcome guests upon the coasts of Britain. During all the centuries that have since passed away Norwegians have directed their gaze from their far-flung coasts westwards towards the sea and the nearest land on the other side. From the days of the sailing ships, through the era of steam, right down to the latest development of the motor vessel, it has always been the sea that has bound our people to other lands and there, first and foremost, to that people, the British, to which in all our mental make-up we are most closely related. As in so many other fields of the spiritual and business life of our country it has also been in modern auditing—here, too, it has been the rich traditional development of the English auditing system that has given we Norwegian auditors impulses to imitative action and has provided the great model for what we have sought to build up in our country. It is therefore no idle word but a true expression of heartfelt feeling to say that it is with the greatest gratitude we have received and accepted the invitation to come here. We come with the certain assurance that the English auditors are the bearers of the highest standard in our profession, and now in our own days, which, in so many fields of activity and in so many countries, bear the stamp of

reactionary movements, will know how to uphold the individual freedom and the individual responsibility that belongs to the efficient exercise of the functions of our profession. With these words I greet the Congress on behalf of the Norwegians participating and wish the Congress God-speed and success in their work.

M. JAMES POLAK (Holland) : My Lord, ladies and gentlemen, in the name of the Nederlandsch Instituut van Accountants I will gladly make use of the opportunity given to us to say a few words at this opening session. The N.B.V.A., N.O.V.A., N.U.A.C. Gen. Acc. have commissioned me to speak also on their behalf. So I may address the Congress in the name of all Dutchmen present here and I may thank you for your invitation, which we have only too gladly accepted. Thank you for your very kind reception, and thank you, Mr. President, for your hearty words of welcome. I hope that the success of the Congress will be in accordance with the great trouble the sponsoring organisations have taken for the preparations. Personally I consider it a privilege to be delegated to bring this Congress this message of your Dutch colleagues. Having had the advantage of spending a part of my apprenticeship at a well-known London Accountant's office I succeeded—better than would be possible by the study of English literature—in getting acquainted with British methods of accounting and auditing, and—as a matter of consequence—in appreciating these methods. I noticed quite a quantity of differences as to the technical methods applied, but on the other hand I observed very much the same fundamental conceptions regarding professional principles, I found the same professional spirit of integrity, good faith and independent objectivity which, also in our country, is considered as the only reliable basis for our professional activity. That was in the first year of the Great War. Since then very much has changed in the world, and also in our profession. We have adopted other methods than we used to follow 20 years ago. I dare say so have the British accountants. New branches have been added to our activity, new problems are in want of solution. But the old spirit of objectivity is still prevailing and will prevail as long as accountancy forms a profession and wherever this profession has come to development. It is this general spirit which, as I see it, makes our profession by excellence fit for International Congresses. Our Dutch Institute has been advocating these Congresses long since: we took the initiative for the International Congress of 1926, we willingly collaborated at the next Congress, at New York and we have come to London *con amore* to have our part in this

Congress. In my opinion this sequence of Congresses should ultimately lead to an international organisation of the profession. We should appreciate very much, Mr. President, if you would take the initiative at some time during this Congress to open the opportunity for discussions on this point between the delegates of the national organisations which are represented here. I want to finish with the announcement that in September next our Dutch Institute will have its yearly National Conference. Although our language may cause certain difficulties I am convinced that the subjects will be of interest also for our foreign colleagues. We should be very pleased if some delegates of our present hosts would do us the favour of visiting us and I may extend my invitation to all members of this Congress, who will all be very welcome.

MONS. S. WOJCIECHOWSKI (Poland) : Lord Plender, ladies and gentlemen, I have the honour to welcome this International Congress in the name of our Association of Accountants' Experts in the Polish Republic, whose delegate I have the pleasure to be. I am very glad to have the opportunity to attend this Congress, on account of the great use that may be brought to our country by the information I obtain on various important questions which have to be discussed here and which are always of great interest to all of us. My joy at being able to attend this Congress is the greater as I am the representative of the Association of Accountants from Poland, from the country that, in spite of her high culture of many centuries, was dismembered and endured a long and hard oppression, from which, to-day, she arises as a new State and is obliged to learn many things anew and avail herself of the knowledge and experience of those countries which, being in more fortunate conditions, were able to develop freely their life and reach the heights of knowledge. I rejoice that the accountants, consolidated in all countries, unite their efforts in the work for the benefit not only of their own lands but also for that of all humanity in the world. That is why, in the name of the accountants represented by me in Poland, I wish to express here my best wishes for the fruitful work of the Congress. At the same time I render homage to the representatives of England for having convoked this Congress in their great and imposing capital.

THE VICE-PRESIDENT : I understand the Roumanian delegate is the late Labour Minister of Roumania. I have been asked to mention that, although we are not discussing labour questions here.

MONS. LE PROF. G. L. TRANCU IASY (Roumania) : Mr. President, ladies and gentlemen, our Congress, coming after the World Economic Confer-

ence, is of the greatest importance. I do not know whether in other countries it is so, but in our country the profession of the accountant has always been bound up with those who have assumed the role of economic leaders. I give all my praise to the theoretic capacity of economists. No other branch of human activity, however, makes possible such a profound knowledge of an undertaking and its management as that of the accountant. And what does the economic welfare of a country mean, if not the entire economic welfare of commercial, financial and industrial entities and the welfare of the family budget? From this point of view our profession has been left in the background, and I do not know if the rather unsatisfactory results obtained at Conferences in which only economists participate, without profound connections with practical life, are not due also to a certain extent to this fact. This is why, on behalf of the whole body of accountant experts and accountants of Roumania, as well as on behalf of the Academy of Higher Commercial and Industrial Studies, I greet, in this assembly, the dawn of a new era in which the real life of the people will be taken into consideration. Due to the fact that by my political activity, though starting as a little bank accountant, I have succeeded in establishing the Ministry of Labour in Greater Roumania, I have been able to create a powerful organisation for our profession, which numbers 12,000 members. An Act of 1921 established the exercise of our profession and protects its rights. We work hard for the creation of the role which must conduct economic life both in private and in State undertakings. This present Congress is fixed in time and in space, so that it will make a decisive contribution in this direction. In time, because in the midst of this economic breakdown the accountant will show the world that the laws of debit and credit are immutable; in space, because it is from this Kingdom that many great lessons have come to us for the salvation of mankind. I have only to quote the pioneers of Rochdale in order to prove this point. Just as these modest workers have shown humanity a new way to be followed so allow me to consider you as the pioneers who will fight, and keep on weaving the threads of practical life, obtained by experience, with those of economic theories, which, isolated, have shown how unsubstantial they are. In this belief, the representatives of Greater Roumania, a country of material and spiritual wealth, unfortunately little or badly known, wish to play their part in the realisation of the work which you are called upon to do. I am an optimist. In the schools of William James and of Emerson I have found sources of energy

and courage. These are among the chief things which we need in the midst of this breakdown. Beyond the frontiers, beyond the customs barriers and currency wars, human suffering binds the nations together. Energy ! Courage !

PROF. O. SILLÉN (Sweden) : My Lord President, it might be contended that every country has the kind and the standard of accountants which it deserves. If this is true, then it is also true that Great Britain must have very high merits indeed. Based on an unbroken development, a glorious development of nearly 80 years, the Scotch, the English and the Irish associations of accountants can now state with pride that the reputation of British accountants could not be better all over the world.

On this occasion, the Swedish Association of Authorised Public Accountants wishes to express, through me, its admiration of the splendid organisation of British professional accountancy. The number of Swedish authorised accountants is not very high ; of course, if we counted all the accountants in Sweden I could go up to several thousands, but the number of authorised accountants is only 70. We hold that the number does not mean so much as the quality, and the qualifications for authorisation in Sweden are comparatively severe, comprising, besides a considerable amount of practical experience, the possession with distinction of a special University degree, requiring at least two years of study.

Ladies and gentlemen, if a person who was invited into a family for the first time should tell the host that the invitation had not come a day too soon, then I think he would probably be considered not to be very well brought up. (Laughter.) Of course, I do not say anything like that, but I wish to say that the Swedish delegates here present, nine in number, have been looking forward with eagerness for several years to an invitation to Great Britain for an International Congress and we are very happy indeed to stand on the classical ground of professional accountancy. We wish to thank the Executive Committee for the splendid work that they have already done, and we feel convinced that, in view of that extraordinary work and also of the interesting programme before us, this Congress is bound to be a success. (Applause.)

(The following Address was handed in on behalf of Czechoslovakia.)

MONSIEUR ING. J. FUKÁTKO (Czechoslovakia) : My Lord President, ladies and gentlemen, Notre quatrième Congrès International a lieu dans un pays qui sut mener l'idée de l'*accountancy* au plus beau épanouissement et qui, par le niveau hautement perfectionné caractéristique et professionnel dans cette matière, est pour nos autres pays moins favorisés un

brillant exemple et le soutien de nos efforts. Le fait que nous autres experts comptables, venant de tous les coins du monde entier, nous nous réunissons déjà pour la troisième fois dans le courant de presque 8 ans pour discuter dans l'esprit de la collaboration cordiale les questions professionnelles, et pour affermir notre solidarité internationale, est certainement un événement, qui surtout au temps actuel de l'autarchie économique mérite bien d'être signalé. I am bringing the heartiest greetings and best wishes for full success of the Congress from a country that is situated in the geographical heart of Continental Europe and on behalf of three bodies of expert auditors in Czechoslovakia and on behalf of the College of Business Administration in Prague which I have the honour of representing. I do so with particular pleasure for I can offer my greetings in the capital of a country to which my nation is very indebted for its unselfish and generous aid in its struggle for independence during the Great War. We also extend our sincere thanks to the sponsors of the present Congress who shrank from no sacrifices in order to enable us to carry on the international co-operation that had been so promisingly initiated at the preceding Congresses. I feel sure that the successful course of the present Congress will at least partly repay the sponsors for the untiring efforts which they displayed for the success of the Congress.

THE PRESIDENT: Ladies and gentlemen, we are very grateful for the acknowledgments which our friends from abroad have paid us in respect of the arrangements we have made for their educational benefit—may we say, for an exchange of professional views—(hear, hear, and laughter)—also, I hope, for a liberal display of our hospitality. We meet tomorrow morning at 10 o'clock to resume the business part of the Congress, but at 9 o'clock tonight we shall hope to see you here prepared to spend with us two or three hours of great enjoyment. (Applause.)

(The session then terminated.)

MONDAY EVENING

RECEPTION IN GROSVENOR HOUSE

An evening reception was held at Grosvenor House, delegates and visiting accountants, accompanied by their wives, and a large number of members of the Sponsoring Bodies and their ladies being present. They were received by Lord and Lady Plender and Sir James and Lady Martin. During the evening a selection of music was played by the band of H.M. Grenadier Guards, conducted by Director of Music Captain G. J. Miller. A buffet supper was served, and a cabaret performance was given.

TUESDAY, 18th JULY, 1933

Morning Session

CHAIRMAN: SIR JAMES MARTIN, M.B.E., F.S.A.A.

(Vice-President of the Congress).

HONORARY } MONS. M. BARBUT (France).

CHAIRMEN } PROFESSOR O. SILLÉN (Sweden).

PAPER

“International Finance”

SIR JOSIAH STAMP, G.B.E., D.Sc., F.S.A.A.



SIR JAMES MARTIN, M.B.E., F.S.A.A.

Vice-President of the Congress

[Photo by Rotogravure

INTERNATIONAL FINANCE

THE CHAIRMAN : Ladies and gentlemen, in opening the ordinary business of the first session of the International Congress on Accounting we are extremely fortunate in having a speaker who is well known internationally to deal with a subject of international importance.

I have much pleasure in calling upon Sir Josiah Stamp.

SIR JOSIAH STAMP, G.B.E., D.Sc., F.S.A.A.

The ink is hardly dry on any written discussion of modern problems of international finance before some kaleidoscopic shift of the world's affairs makes a new aspect dominant and brings to the front a different question of principle. We find left open as a matter for discussion whether a single metallic standard, like the gold standard, is capable of serving the double purpose of a stable standard of values for domestic and internal use in every country and an international medium of exchange for settling trade, financial and political balances. It has been seen that the presumptions of very considerable mobility of economic factors upon which the whole gold standard theory rests are at the moment unjustified so far as most civilised countries are concerned. The calls made upon these factors are extremely severe, if unsettled balances of international trade through intense economic nationalism, industrial planning and other changes in *laissez faire* are to prevail. The response of the factors instead of being greater, because of the greater demand, has become less. In other words, the existence of political payments for international debts, the desire to take no payments in the form of goods if possible, and an intensely sensitive set of money markets, where international financiers move money balances about regardless of the goods that ought to lie behind such movements, all mean that gold must be moved about more than it would in a less nationalist frame of mind, and a world where international finance was less

mobile. For a gold standard to work in this situation satisfactorily, great adaptability of costs is required, especially in wages, and we all know that collective bargaining for wages and the attempt to get some stability of understanding, have moved this possibility in an opposite direction. Small wonder then that people dealing with the theoretic aspects of international finance have become doubtful whether a gold standard which depends for its success *either* upon complete *laissez faire*, or upon a very elaborate and well understood management, can succeed in a world where *laissez faire* is increasingly discounted and where the technique of international management is not yet elaborated. The minds of many thinkers on this subject gravitate, therefore, to one of two alternatives. First, to a choice between the importance of international trade (with a managed internal stable currency and fluctuating foreign exchange), or a fixed exchange and fluctuating internal prices. The second is some kind of duplicated mechanism whereby internal prices are ruled by one set of conditions and a special monetary standard, while gold or its equivalent remains the international medium, thus having finally a rate of exchange for domestic use between domestic currencies and the general currency. Now all these latter schemes, however ingenious, do not get away from the fact that quoting the dollar in an international unit, say, the gramme-or—and quoting the franc in the gramme-or—still means that there *is* actually a rate of exchange between the dollar and the franc that at one remove influences the trade between their two countries. It does not solve the problem of international trade, but merely tries to sublimate it, and enables us to focus attention upon domestic price levels. The problem of exchange in international finance is, in the long run, whether we can secure, by a single mechanism, stability of price measurement in each individual country, which will enable that country to function economically, and, at the same time, a medium of international exchange which will not unduly fluctuate. It has been very well said that the proportion of foreign trade to total trade in the U.S.A. is relatively so small that the United States should consider first the monetary mechanism of her domestic market, the price level that suits her, and let questions of foreign trade find their own level. But, on the

other hand, that foreign trade matters so much to Great Britain, compared with slight differences of the domestic level of prices, that she ought to think first of the stability of sterling and only second of the convenience of the right level of sterling in her domestic market. Therefore, the United Kingdom can afford to let the United States choose the general level of prices first of all, provided that the States in turn will give the United Kingdom a good bargain, so to speak, on the parity of sterling. Now something like this is only emerging as the problem at the present moment, at any rate, so far as the United States is concerned. It must always be borne in mind, however, for Great Britain, that it is not merely a question of the volume of foreign trade as such. One of the great services exported from Great Britain is a quality called *stability of value* in the sterling bill, and the services of a negotiating machine behind it. The use of the sterling bill, or quotations in sterling for insurance, &c. &c., is a valuable national asset, which we have been able to place at the service of the world. We have, therefore, much wider interest than merely the ability to exchange goods on satisfactory terms with foreign countries, and get them paid for. We have actually provided a convenient mechanism or means of exchange whose main characteristic in past years has been its stability over its period of life. Now it may still be thought by a large part of the world that sterling is likely to be more satisfactory as a currency tied to gold than as a currency managed by a Government and a Central Bank, however well accredited and free from political pressure. We must expect to find, therefore, that all people who realise the importance of foreign trade and the services rendered by the City of London will have a natural leaning for a return to gold as the ideal state of affairs. They will be all the more confirmed in this course because of the absence of either experience or reasoned technique as to how currency divorced from gold is to be finally managed. They dread, however, a return to gold *without* certain preliminary understandings, if there is any risk of a collapse and a fall from grace a second time as unavoidable and as disconcerting as the first. They naturally say: "Great as our belief in the gold standard is, we would rather carry on as we are, managing our price

level until these things can be settled, than make a precipitate and ill-considered arrangement."

The problems of international finance, therefore, range themselves in three degrees of urgency. The long distance one is—can a gold standard ever work satisfactorily in a world which is neither pure *laissez faire* nor pure control, but a curious mongrel mixture? If it can, what are the conditions of its working, and are they likely to be acceptable? What are the difficulties in each country which have prevented its working? If it cannot, what kind of arrangement do we seek domestically and internationally to take its place? Do we have a tabular standard, or a commodity dollar and commodity sterling, and what factors do we introduce into the measure of value? Do we base it on articles of international exchange, or does it include also entirely indigenous and domestic consumption? How do we wish domestic prices to behave? Should they fall and, if so, do they fall only with the increase in productivity per man hour? These are the long-range problems which the world will have to face.

The next line are the problems relating to the return to the gold standard and the immediate rules of the game that are necessary for that purpose. There is not the slightest doubt that if America had not gone off the gold standard through her domestic difficulties, the pressure upon us at this London Conference, with her influence joined to that of the Latin countries, would have been terrific. We should have been the world's bad boys, whereas now we are in the position of sympathising with both sides and trying to bring them together with the City leaning to one and the West-end leaning to the other. The immediate problem is how to maintain a reasonable framework of finance for foreign trade, while one important party to that trade and to world values is conducting a financial revolution and is giving no clear indication as to the point at which he would desire to hold it and within what range of action he can succeed. Is it possible to find a reconciliation between the domestic ambitions of President Roosevelt and the natural desire of the European countries to find a suitable basis of international trade, free from the fortuitous and disturbing elements of depreciated

currencies in export trade, and free from the danger coming about through the movement of balances between financial centres following "flights" from one currency to another. Before we embark upon any attempt to answer this, it is necessary to get clear the number of different notions which are hopelessly mixed up from time to time in the discussions.

THE URGENT PROBLEMS

Apart from immediate recovery, the three chief underlying problems for the government of nations are—

- (1) The balance between individual liberty and social direction.

We have a natural philosophy of freedom and are continually modifying it to make our machine work. We are constantly putting larger and larger patches of social regulation upon the torn garment of personal liberty. In Russia to achieve success they are putting larger and larger gussets of personal liberty into the strait-jacket of economic communism.

- (2) The cession of aspects of national sovereignty to international direction in economic questions.

- (3) The measure of value—the monetary problem.

Money is known to us all as a—

- (1) Medium of exchange ; or
- (2) Store of value ; and
- (3) Measure of value.

But we do not usually recognise that it performs the two first functions almost by mutual exclusion, for when it is being most used as a *store*, whether in a stocking or a safe, or an idle bank deposit, it is not serving to *exchange* goods. So its whole use is not really for both uses at once, but is divided between the two uses. But its third function, a measure of value, is not absolute—it depends upon the way in which the first two share the field. For if money is used a great deal as a store, and only to a minor extent as an exchanging mechanism, the "measure of value" will turn out to be quite different from what would result if money were used far *less* as a store and far *more* as an exchanging mechanism. The level of prices measured in money will be relative to these proportions between storing and exchanging. You cannot measure a yard with a

tape measure if half of it is in your pocket. The money problem is a baffling blend of purely mechanical and equational elements with psychological and emotional elements. Upon its solution depends the whole possibility of a competent and highly-organised civilisation. It is being brought to a severe test in the present conference : Failure might result from any one of the following :—

- (a) The persistence of political nationalism in an economic world.
- (b) Inability to suffer local disadvantages or changes for the greater common good.
- (c) Inability to liquidate the past.
- (d) Genuine difficulty in getting a common view about the " rules of the game " in a technical sense.
- (e) Human reactions. While facts must prevail ultimately, what people think about facts may be even more important. If you think a credit machine unsafe, it *becomes* unsafe. You will run as fast from a dog that you *think* is a wolf, as a real wolf, and any risks attached to running are present in both.

The complications of the situation immediately before us in America and Britain depend, not upon two variables as most people often think, but upon three, and it is impossible to be clear which of these settles itself first. Certainly none is independent.

The first recognised variable is the *relation of the dollar to commodities*, the purchasing power of American currency, on which depends the price level in dollars, the ease or difficulty of making profits, and, therefore, the ultimate level of sound stock and bond values. This therefore determines the validity and security of their debt structure, mortgage and interest payments, the level of real wages, and the extent of their unemployment. It is to them by far the most important relationship that has to be explored, and they are taking important and novel steps to improve it and control it. Whether a rise of prices by itself will make all their debtor relationships quite comfortable without some adjustment in the amount of certain debts also I cannot say, but clearly the main burden of putting things right ought to rest upon the same agency that got them wrong, viz. a change in the dollar price level.

The *second relationship* we have to bear in mind is that between

dollars and foreign currencies, especially those not on the gold standard, and I will express this, for convenience, as the dollar sterling exchange or parity. We have been asking, first, what is the "proper" exchange rate, and, second, what it ought to be fixed at, so as not to prejudice the foreign trade of either side or favour it unduly. Now, the "true" or proper rate depends on a parity or equality of purchasing power—the number of dollars that will purchase the same quantity of general commodities in foreign trade as a pound sterling. If this were not so, strange results would occur, and it is the natural "norm" to which the exchange rate tends, even if for other reasons it never touches it. It is clearly related to the internal or domestic price level, too. If the dollar is inflated or multiplied so that it buys less commodities than before and prices rise, but sterling remains constant in its purchasing power, the United States may secure a more comfortable internal situation, but the number of dollars to be given for a £ would rise. It might easily rise to \$6.00 or \$7.00 (neither being linked to gold). If the price level rises in one country so that the purchasing power of bond interest and unaltered wages is reduced, and more of the price goes into profits than in the other country, it can afford to cut prices slightly in a foreign market and get more business without losing, but, indeed, making that extra profit which comes to a larger volume at a slightly less nominal rate of profit. So that amount of extra inflation which depreciates the exchange against sterling is good for American foreign trade and bad for competing British trade, and hence comes the temptation for a race in exchange depreciation. But if it proceeds so that the foreigner distrusts the purchasing power of dollars to hold good, he will force the selling, never hold, clear out his deposits, and the exchange takes a nose dive for psychological reasons *quite unrelated to the comparison of price levels*. This has important effects we have no space to discuss here.

Now the foreign trade aspect of exchange stability between two currencies is most important to the country with the greatest dependence on foreign trade. It is almost certain that we could not expect that the American dollar price level would be doubled (American costs remaining the same) while the British sterling level

remained constant, and the change be taken up in a new rate of exchange which produced this bad competitive result. We should certainly find that the British price level would rise too, so that the exchange rate would not need to change to so great an extent.

When the sterling dollar rate changed after Britain went off the gold standard it was because the American dollar price level was allowed to fall continuously with the greater value of gold, while the British sterling price level was not allowed to be further deflated. It was not for any conscious attempt to secure a foreign trade advantage—this is a derivative and not a cause.

Now the third relationship, which we tend not to think explicitly about, is that between *gold* and *commodities*. Until recently gold has become steadily more valuable, gold prices have fallen, but we do not know how the gold relationship will behave in future. If you know the relation between the dollar and commodities, and that between gold and commodities, you can deduce the relation between gold and the dollar, that is, you know how much devaluation of the dollar in a return to the gold standard is necessary. If you know the relation between sterling and commodities, and gold and commodities, you know how much to devalue sterling in a return to the gold standard. The two results will give you automatically the par rate of sterling dollar exchange.

It is idle for America to discuss the amount of devaluation until they have determined what dollar price level they want for their domestic structure, estimated the gold price level and compared the two. It is idle to discuss the rate of exchange with them at which we shall go back to the gold standard until we know the amount of devaluation they must have. The two relations are inter-dependent, and dealing with one only gives results which must be rubbish to practical men.

The key to the situation for a permanent return to gold, on devalued levels, producing rates of exchange which are fair to foreign trade, and consistent with price levels that agree with industry and debts, is still therefore the behaviour of gold (and the credit systems based thereon) compared with commodities.

What will be the future value of gold? So long as we are dis-

contented with non-gold currencies and regard gold as a safe haven to which we hope to return it will be important and desired. But if we get on well without it, and it has no monopoly of currency basis, and we evince no desire to return to it, it will rapidly become less valuable in relation to goods, gold prices would rise rapidly and pass the old parity of dollars and sterling, so that our currencies, instead of being devalued in terms of gold, would all be super-valued !

There is a great deal of unreasoning prejudice against the mere term *inflation*, because of past history which is in no way comparable. I should no more call the reflation which is now taking place from these ruinously and abnormally low price levels "*inflation*" than I should call a man a *mountaineer* when he is coming up from the cellar.

We must ignore for the present the disturbing question as to the ultimate movement and value of gold and assume that it is a constant factor. Then we must do everything we can, country by country, to prevent the currency unit engendering a depreciation on purely speculative lines. While a depreciating currency will do much in itself to introduce a movement of prices in sympathy, it may for a long time be parted from it and we should aim at keeping the Exchanges as near purchasing power parities as possible. It can at best be only empirical and approximate, but it is better than having no aim at all, and it is quite possible to let attempts to control the dollar go as an element in foreign trade, and to get equivalence between the other non-gold currencies and gold within broad zones for short periods. If it is stated to be the avowed object of a gold country at the present time not to let gold depreciate in value, nor the currency based upon it, then the immediate question we have to ask ourselves is : Are we satisfied that our present price level meets all our wishes and does justice to the requirements of our economic organism—in other words, can substantial profits be made ? If not, then we must face up to the surgical operation of altering the exchange rate between sterling and those countries, otherwise the object of adjustment of our price level is defeated. It would perhaps be better to do this by modest stages, and not very perceptibly, than to wait until the movements of the dollar currency now left to

itself have become so striking as to cause considerable inconvenience to international trade and compel the movement of sterling, which in the endeavour to make an adjustment with the dollar in trade, would necessarily involve a very sudden break indeed with the gold currencies.

It is not the purpose of my paper really to discuss the day-to-day problem of the moment, but I am merely introducing this factor because people are sure to declare otherwise that the paper is too abstract and does not face up to current difficulties.

Let us touch the middle range of problems, viz. the return to the gold standard.

We are increasingly realising that monetary science can never be exactly laid down because it is a subtle compound of the quasi-mechanical and quantitative forces and equivalents of the pure quantity theory of money with an attitude of mind about money, and if that attitude changes, some of the principles will refuse to work. It is as though we constructed a machine with a propeller to work in water and then asked it to do its work in syrup or in air. All the quantitative relationships upon which we build a science depend on reasonable consistency in the reactions of economic men in groups to certain stimuli. We realise that nothing is either good or bad, but thinking makes it so, and that that system will be unsafe which people persist in thinking is unsafe. In short, the element of confidence is capable of much wider variation than we had thought and, taken beyond certain limits in either direction, it renders possible or impossible, as the case may be, the application of our principles. If people in the mass persist in thinking that certain monetary mechanism is not safe, they will certainly succeed in making it unsafe. In the field of currency mass psychology has its greatest scope for economic derangement. Although at bottom economic facts are the things that matter in the end, in the short run, what people think about economic facts, however mistakenly, is just as important as the fact itself. It may be a long time before they find out their mistake and gain confidence, and, in the meantime, their flight from one fancied horror will bring new horrors in its train.

The incomparable derangement in which we now find the world's

monetary affairs, and the exceedingly difficult task before us of restoring the damage, and also making a new machine, which will not go wrong in the same ways as the old, call for a careful examination in every country of the particular ills to which it has fallen a prey ; the particular hopes that it desires to preserve and the particular psychological difficulties that its history and traditions and policies make likely to persist in all the separate countries. What are finally emerging as the particular difficulties of the past in relation to monetary affairs ? There have been many charges and counter charges—some of them from abroad, some from political rivalries within and some from a genuine conflict of economic ideals. Many of them depend upon different estimates of what human nature can stand and understand.

What, then, are the weaknesses that stand revealed so far as England is concerned ? I should enumerate seven as being the most important or distinctive. First, London, by reason of its immense financial services to the Empire and the world, by its traditional leadership in the gold standard from the 19th century, and by the prevalence of the sterling bill, has been a too sensitive reservoir of world funds. This situation might have been different if any one person or institution had been conscious of the totality of the movements, but in the aggregate we have been ignorant of them. Even at a time of special investigation, when the Macmillan Committee on Finance and Industry was paying particular attention to the subject and collecting special *ad hoc* statistics, they failed to grasp the whole truth. In asking themselves the question “ how sensitive is London to a sudden flight from sterling, either in distrust of London and sterling or because of difficulties in foreign monetary centres, making it necessary for them to repatriate their deposits,” they ascertained the deposits in the London banks and came to the conclusion that London was reasonably secure on balance from foreign pressure, but they did not know and did not ascertain the deposits in the London branches of foreign institutions ; nor was *anyone* really seized of the actual position in London ; it had been no-one’s business and it was not realised how increasingly sensitive this liability had become. If any market was to have as great a capacity for

variation in range and as great a sensitiveness, then it could only do so with safety if the conditions were known, at any rate, to someone in control, if not publicly. But these vast aggregates were varying without the knowledge of any living soul ; varying in hidden conditions in which disaster was a question only of degree. A *sine qua non* of the future, therefore, is that the Central Banks or the Government should have some fairly approximate and frequent up-to-date knowledge of the total balance "time quality" of indebtedness in its markets.

In the second place, the charge sometimes made by continental writers that the responsibility for working the gold standard throughout the industrial organism was not recognised must be admitted to be in part true. The gold standard certainly pre-supposes that the flow of gold to balance international trade must work out its effects in raising and lowering costs ; otherwise, that standard is meaningless. The gold was flowing for political reasons and other reasons that were artificial compared with the balance of trade, and every effort was made to prevent wages and other costs rising and falling. The natural reactions of the gold standard were, therefore, denied—denied no doubt, or prevented, in self protection, but all the same having the effects of *prevention* in destroying the self-balancing qualities of the gold standard. England's reactions were too tardy and too limited, and the consequence was growing unemployment, due to the increasing level of real wages and the spiral of deflation. The lesson for the future is that gold ought not to flow for any other purpose than trade balancing, and that if it does *not* then the responsibility for allowing it to have its natural effects upon the price level can be more readily accepted ; but all the same it ought to be accepted. The social question, however, arises as to whether democratic institutions and Governments will trust themselves to this mechanism, so sacred are the obsessions about the fixity of money wages and interest contracts.

In the third place, the flow of monetary savings or subtractions of purchasing power from current expenditure is too steady and unyielding in a country with a network of provident institutions, insurance societies, sinking funds and other irresistible streams which

do not respond to the governing factor of price. If the change in the price of money has not the time-honoured economic effect of other changes of price in equating supply and demand, we are bound to get a condition of unstable equilibrium; and the phenomenon of savings being far in excess of investment, and bringing about an excess of current production over current consumption, and consequent unemployment, is one that is partly due to this insensitiveness. It cannot be said that we ought for the future to restrict the amount of savings in these compulsory directions, but we ought to find some way of making the investment market more sensitive and absorbing. This is mainly a problem of confidence and perhaps when the other factors are put right this new confidence will be a natural product.

The fourth aspect is allied to the foregoing excessive steadiness of the flow. It is that the connection between the capital uses of money and the supply of money for those uses is too remote and disjointed, it being impossible to retard or enlarge the flow, as the case may be, very quickly or sensitively, so that the next best thing is to cultivate the technique through public and private investments, acting in a complementary way to each other, of absorbing these funds; and here large questions of politics of governments are raised. Expenditure on public works, however useful for economic reasons, raises questions of politics and efficiency which may not be easily solved.

In the fifth place, a centre like London, which is looked upon to superintend and supply funds for foreign borrowers all over the world, can in the long run only supply what is left out of the total savings of the country after home capital is absorbed. If at any time these claims are greater than the home savings, difficulties are likely to arise.

Now the perfection of London as a lending market is a separately developed technique and it has no necessary connection, except so far as checked by underlying economic forces, with the total savings available at any time. It is possible for it to go on approving loans and issuing them, while its citizens have not really put themselves in a position to implement those loans out of their own resources.

The underlying tendency then is for the funds to be drawn from foreign markets on short term, and we get a lack of equilibrium between the "time" quality of the money loaned and money borrowed, which some day is fraught with difficulty. Here again, a closer central control over private lending houses seems to emerge as desirable.

In the sixth place, if London lends abroad on a large scale, but the North of England, in its exporting industries, has costs too high for successful foreign exportation, then our industries will fail to implement what our financiers have promised to lend, for in the long run, financial loans must be implemented by industrial exports, except so far as they absorb foreign funds due to us. If our export costs are maintained, by trade union action or otherwise, on too high a level, then a great strain must be thrown upon the gold reserves or upon a good equilibrium between lending and borrowing. In the past no attempt has been made to link the amount of our London lending abroad with our power to export.

In the last place, with a rapidly falling price level, real wages have increased at too great a speed. The purchasing power has been transferred from the hands of ordinary shareholders and institutions, who might have used it for increasing investments abroad. It has got into the hands of millions with increased purchasing power, who have enjoyed their new-found command over foreign produce of all kinds. In this way it has become fatally easy to squeeze the favourable balance of trade into the standard of living and to increase the actual total quantity of goods purchased from abroad at a time when the actual capacity of a country to purchase, judged by its productive power, is falling rapidly. This was one of the reasons why the balance of trade went so heavily against Britain in 1929, 1930 and 1931. For the future, in order to avoid it, we can only say that prices ought not to be allowed to fall because they make constant money wages into a dangerously high real wage. But inasmuch as this is a pious wish, easier to enunciate than to achieve, we have to say the next best thing, viz. that if prices do fall and real wages do rise, there should be a greater measure of adjustment in the industrial machine to counteract it. This answer is also, under

modern conditions, more or less visionary. Perhaps the next best thing is to impede the flow of goods from abroad by artificial means, duties, &c., in order that the balance of trade may be properly protected and real wages prevented from becoming too high. It is a hard doctrine, but the proper economic line here would be to make good some of the transfer between the ordinary shareholder and the receiver of relatively fixed incomes and wages by relieving the taxation on the former, enabling him to have more to save, and increasing the taxation on the latter, preventing him from straining the gold position, endangering the foreign loan market, and upsetting the whole economic organism by an excessive import of foreign foods and luxuries.

These seven fundamental causes are interlocked and interlaced. I have had Britain in mind throughout and I do not doubt that a similar survey of the strains and stresses in other countries will throw up tendencies which are individual to each of them. It is only by agreement upon the same central principles and careful protection against our own idiosyncracies that we can hope to work the international machine.

The third problem of long-range possibility of a single measure of value domestically and internationally in a world that is neither *laissez faire*, nor controlled, is, I suppose, at the bottom, a political question. How far shall we cede national sovereignty in financial matters to international direction and control? Secondly, how far will political governments be stable enough to run currency questions without political bias, and third, how far will national psychologies enable us to eliminate great waves of expansion and depression. To cut across these large problems which will decide these broad questions of monetary measurement in the future, we have the more pertinent question: how far must the financial world be regulated and ruled by purely accountancy conceptions, which are, after all, only conventions and the very mention of which will put up all your bristles?

Accountancy is based firmly upon the understanding that money values are real and unvarying, and has no way of recognising the fact they are not. The conventions it adopts dominate banking and

contracts and, while a great protection against fraud and insecurity, are almost wholly vicious in their influence upon the amplitude of credit-cycles, making booms and depressions more extreme than they need be. That results from a constant comparison of two kinds of asset, money and fixed money claims like mortgages and debentures and their interest, with the varying monetary expression of the values of physical assets, which are not *in pari materia*. When prices are rising, profits are higher because of the lag between the prices paid for the goods in the early part of the year and that realised by sale later, because of the lag in wages, because of the provision for wasting capital being only upon the old cost, and not upon the year's share of a renewal cost, because of the ease of repayment of fixed charges, because of the diminishing real value of assets held, or fixed money equivalents. When prices fall, real profits are similarly cramped, except for the convention about stock valuation and depreciation of securities. These exceptions create so-called secret reserves.

Now, if the price level were moving to a completely and permanent new level it would not much matter, but if it is fluctuating about a norm or level, the incentive to launch out and increase business when profits are increasing (not through increased trade, but changing prices) is unduly increased, and when profits are falling is unduly diminished. Prudent businesses do something to counteract this by making larger reserves in good times to be drawn on in bad, but that does not alter the effect of expansion or contraction as *incentives*.

If we are entitled to assume that every upward oscillation of price is going to entail one downwards of corresponding magnitude, then obviously we ought to perform that operation which accountants invented during the war, which was condemned by tax experts, and which was never effective in practice, viz. to divide profit into that part due to output on an unchanging price, and that part due to the change of price—leaving it assumed, I suppose, that any increase in output would have come about without the price increase and is entitled to be reckoned as profit not dependent on the impetus of price change, which is hardly true, though there is actually much less of such increase for all commodities taken to-

gether, on a price change, than might be supposed. Then we are entitled to regard the price-change-profit-section as only a suspense account to be held against the inevitable deficit. For on the falling market the true economic profit is greater than that shown, even for the smaller output, and the suspense account comes into action to make up the difference. The excess profit consists not merely in the difference in the price at which things can be bought *wholesale* on the day of sale compared with the actual price at which they were brought into stock, in a merchanting business, but also in a producing business in the excess of the price realisable over previous prices realised, assuming that costs have not equally advanced. It is not enough, economically, to hold these sums in reserve and *invest* them—they must be treated as a non-tangible asset, or of course in the balance sheet balanced by a bookkeeping liability, though a more consistent plan would be to write down the assets themselves.

Now the non-distribution of a part of the proceeds of production during times of inflation has important economic consequences into which I will not enter. In the ordinary way, a reserve out of profits depletes purchasing power in the hands of the shareholding public, goes through the investment market and increases the supply of savings more directly, or increases stocks, and so demand for capital goods tends to be stimulated and that of commodities restricted, but on the whole, the total purchasing power is only reclassified and not reduced. In the case to which I refer, the reserve must be held idle. Two important anti-inflationary influences would therefore be at work: first, a psychological one on undue business expansion, and second, a physical one annihilating some of the purchasing power created or “tokened” by current production. A converse process would be set up on a fall in prices below normal. One could avoid all this if accountancy permitted fixed value assets to be written up and down, before computing profits, affecting profits by its appropriate annual equivalent, but this no doubt introduces counter considerations of individual security.

A further field in which the domination of accountancy conventions reverses the true direction of economic forces in changing values, with a wide repercussion on international finance, is the theory of

the stock exchange price. We should ordinarily understand that Wall Street would register what is actually happening or likely to happen in the industrial world, providing a register of results, a thermometer so to speak. Instead of that it is often an originating cause, instead of a record or an anticipation of what must be. A burst of bear speculation, or a wave of pessimism and selling we will say lowers the price of a particular stock some points. The banks, scrutinising their loans and collaterals, wish to satisfy their accountants' rule that loans should be covered, or proportionately so, and other conventions of soundness and liquidity, and, although nothing whatever has happened to the actual business itself to justify the change, they therefore automatically call in, reduce, or ask for more cover. The industrialist soon feels the effect—he finds his range of credit reduced, and decides to restrict his holding of stocks by selling low and buying less, or decides not to enter into some additional commitment he was contemplating. Deflation has set in, originated from the wrong end and working through an accountancy rule. The lowering of business activities then actually lowers a stock exchange price on merits, where it has been put without necessity.

The prudential rules of accountancy that in stocks and securities diminished values should be taken notice of, but increased values must not be considered, however good for individual security, are economically on a wide scale, disadvantageous. The theory that if A. holds government stock costing £10,000, and on its rise to £15,000 can do nothing about it if he still holds it, whereas B., having sold at £15,000 and reinvested that £15,000 in another stock which stands at £15,000, is entitled to use a capital profit of £5,000 *because it is realised*, is economically nonsense. Both A.'s original stock now held *worth* £15,000, and B.'s new stock (perhaps the same kind) *costing* £15,000, and showing no depreciation, are *equally liable* to reaction to £10,000. Some of the accountancy conventions on foreign exchange are not without influence on international finance.

In conclusion, I would urge upon my hearers that there are no cut and dried solutions either of the immediate or the long-range

problems, for we have not yet made up our minds what kind of a world we really desire to live in, and the balance between the principles of the world as an economic unit, or as a series of fortuitous non-economic units, between congruity of aims in an international scheme and the joy of independence and running our own show even at an economic cost, has not begun to be settled. The settlement affects every financial solution in the international field.

DISCUSSION

THE CHAIRMAN : Ladies and gentlemen, the next speaker will be Professor T. E. Gregory, Cassel Professor of Banking of the University of London ; but before I call upon Professor Gregory I want to say that amongst the other people will be Professor Jones of the University of Leeds and three Delegates. Now the Executive Committee are anxious not to cut out from the discussions any Delegate who wishes to take part in them, but we must have organisation in this Conference if we are going to succeed, and it will be necessary, if any other delegate wishes to take part, for him kindly to send up his name to me and I will endeavour to fit him in the short time which is at my disposal.

I now call upon Professor Gregory.

PROFESSOR T. E. GREGORY : Mr. Chairman, ladies and gentlemen, I am afraid some of you are going to be disappointed if you think this is going to be an exhibition of David trying to slay Goliath. It is going to be nothing of the sort because, as the principal speaker rightly said, the issues are so multitudinous and vast that there are points of agreement as well as points of difference between all economists at the present time.

Now I am going to keep myself strictly within my time limit, and there are four things, and four things only, to which I should like to refer. The first is this : There is no agreement at the present time on first principles. It is very important to emphasise that because there is a natural impatience on the part of the public, and on the part of business men, that something should be done. Now, if you are walking about on a mountain precipice in the fog, it is no good saying something should be done, if you do not know the way. The only thing to do is to stand still until the fog clears, and I venture to suggest that it is highly dangerous in the interests of business itself if highly technical and difficult problems are to be forced upon the world, merely in order to satisfy mankind's natural impatience. There is no agreement on the two fundamental questions with which economists are concerned in the monetary field to-day of which the immediate one is the question of whether the trade cycle can be con-

trolled, and, if so, how it is going to be controlled ; and there is no agreement either upon the long period problem as to how we really want prices over, let us say, the next 25 or 50 or 75 years to behave. It is not any good blaming the economists. These differences of opinion arise whenever you have an intricate subject matter which cannot be controlled at will. But what is true is this—and I should like to emphasise it—that we know certain of the practical dangers which very easily follow from the adoption of certain kinds of measures. I agree with Sir Josiah Stamp that it is not any good prejudicing the whole price outlook by merely throwing mud and using the word “inflation,” but it is nevertheless true that there are very great practical difficulties and very great practical dangers arising from the circumstances that the credit and currency machine can very easily get out of hand once an upward movement of prices has been admitted, and my only predominant feeling about the extraordinarily interesting experiment which is being tried in the United States to-day is this : It is called controlled reflation, but there is the danger that it will be reflation without control, or control without reflation. The Americans are trying an experiment which everyone will watch, I venture to think, with the greatest interest both from the theoretical and the practical point of view ; but I think we have also got to admit that there are immense dangers in the American experiment. We do not know where it is going to lead either them or the world. So long as we do not know the fundamental correctness of one view or the other we have to confine ourselves to practical and commonsense considerations and such considerations do point to the fact that reflationary experiments have, at any rate in the past, shown a distinct tendency to go wrong as soon as the currency of a country is dissociated from some firm connection with a metallic base. That does not dispose of all the arguments pro and con. It is, however, I think, a truth which can be drawn from the teachings of past events ; and, therefore, although I agree with the principal speaker that we have no right whatever to dispose of the American experiment merely by calling it inflation, we have got the right both as common-sense individuals and as technical experts to draw the attention of the public to the very grave difficulties and the very grave dangers which are likely to arise in the course of that experiment being worked out.

Now, the second point is this. I believe with Sir Josiah Stamp that all over the world there still is a failure of adjustment between the level of costs and the level of prices—that is the depression—and until the level of cost and level of prices are adjusted to one another the depression can-

not possibly lift. But at the same time my second point, I think, would be this. The degree of adjustment which is necessary in different countries at present is very different. In some countries there has been a very much greater degree of adjustment between the new price level and the level of costs than in others, and I think that difference is most marked if one takes the extremes in the capitalistic world between this country and the United States. One of my difficulties about accepting the present American policy is that I think America, of all the great capitalistic countries, had even before the dollar broke away from gold gone much farther in the way of adjusting prices to cost than, for instance, we had done. Of all the great industrial countries we are at the present time the most rigid and the most inelastic ; and I cannot think that the solution which might be appropriate in our case is necessarily as appropriate in the case of a country with so remarkable a mobility as the United States has shown until the passage of the Industrial Recovery Act. One of the side issues—it is a side issue—only from the standpoint of monetary theory, and from no other—involved in the reflationary experiment in the United States is the introduction of what I will call political inelasticity for its own sake. I cannot help thinking that the Industrial Recovery Act which proposes to put all American industry into a kind of strait jacket is singularly inappropriate at a time when America is trying to raise the level of prices above the sunken level of costs. There, again, you have an enormously difficult situation, a circumstance with which Sir Josiah Stamp is more familiar than I am, where you have two Government Departments engaged in the good old game of trying to defeat one another. But whatever one may think, either of reflation or control, the two things are not necessarily compatible with one another, and may raise very considerable difficulties in the very near future. In fact some of those difficulties have already been alluded to very distinctly by General Jackson only ten days ago.

Now, my third point is one with which I think accountants particularly ought to concern themselves in the very near future. It is this. Sir Josiah Stamp in his paper drew attention to the enormous importance for a country so dependent upon international trade as we are of having a stable basis for international trade operations. With that view, of course, I am in entire agreement ; but I venture to think that he has failed to stress as much as I should have liked him to have done the enormous importance of stable currencies in view of the enormous international flow of investment with which this country has been so intimately associated for a century and a half.

Now, Sir Josiah Stamp in his paper hinted—I do not know whether this was his own view or not—at a state of affairs in which it might become desirable for international investment particularly, and perhaps for domestic investments also, to be subject to some kind of Governmental control. That raises a very vast question which I cannot deal with here ; but there is one other aspect of this question of investment to which I think it is appropriate to refer when we are discussing the international side of the problem. It is this. The raw material producing countries must, if the present tendency of the world's population continues, ultimately industrialise themselves to some extent. The big problem which arises is where the capital for this industrialism is to come from and an old-fashioned individualist like myself would say that there are very many advantages both to the raw material producing countries themselves and to the old investment areas if the capital which they require could be furnished to them by those centres in which the need for investment is greater than it could possibly be in the newer areas of the world. I think Sir Josiah Stamp will agree that there is a great deal to be said for that particular point of view, not only from the standpoint of the world as a whole but particularly from our own standpoint, because we turn ourselves by doing so into a great international investment trust so that whenever anyone is making any money anywhere some fortunate inhabitant of Great Britain is enabled to go on maintaining his standard of life. If you agree with me for the sake of argument that international investment, whether on the old scale or on some new scale, must go on, then it seems to me of the first importance that we should have an international currency in terms of which that international investment can go on. As it is, international investment has become, together with international trade, nothing except a gamble in the future values of currencies, and I cannot think that is a sound and healthy state of affairs for the world to contemplate. The progress of the constructional industries and of the heavy trades in this country and in the United States must depend very largely upon the flow of orders represented by international loans, and one of the reasons, not the only reason, for the depression in the ship-building trade and in the iron and steel trades, not only here but everywhere, is the enormous check to international investment which has been going on in the last three or four years. That is the third point to which I wanted to refer.

My fourth point is this, and it is a very serious one. Even if you could adjust the level of costs and the level of prices to-day the world is burdened

at the moment—let us face the fact perfectly frankly—by a great mass of indebtedness and mortgage burdens of one kind or another, the value of which is highly problematical. Now, as far as I can see there exists no kind of machinery whatever by which, if the world has to face the problem of cleaning out a financial situation of this kind, it can be speedily, easily and fairly accomplished. The fundamental necessity, it seems to me, over and above a stable international currency for a recovery in world conditions to-day is the invention of machinery by which past debts could be liquidated without intolerable delay and without causing unfairness either on the part of the debtors or on the part of the creditors. Now, the question of creating a machine of this kind has recently, I understand, been discussed by the World Economic Conference, but the World Economic Conference unfortunately is not likely to remain in existence long enough to solve the problem which it has posed. May I, therefore, venture to suggest to an international body of accountants that here is a problem of the most practical importance, of the utmost significance, and which can only be solved, if it is going to be solved at all, by those of you who have experience in the liquidation of international debts putting forward suggestions which appeal to the practical men who have ultimately got to solve these particular problems. I am quite convinced that if you want international investment to blossom again you must prevent the kind of frozen international situation which has resulted from the price fall of the last few years. I think the answer to the question is partly this: You must prevent prices from falling as much as they have fallen recently. That will make the problem less urgent; and the way to prevent prices falling as rapidly as they have been falling is to prevent the kind of boom which we know will follow; but apart from this general question which concerns economists and business men generally rather than accountants there does seem an important residuum, namely, the problem of what you are going to do with international debts when they go sour. I commend that to the assembled accountants of the world. (Applause.)

THE CHAIRMAN: Ladies and gentlemen, the next speaker is Mr. Alderman C. Latham.

MR. ALDERMAN C. LATHAM, J.P., L.C.C.: Mr. Chairman, ladies and gentlemen, it would be otiose on my part to pay tribute to Sir Josiah Stamp for the very erudite paper he has given us this morning, especially, for reasons which we understand, that we had no opportunity of an earlier perusal of a paper embracing very complex problems in the international economic field.

To deal with the last section first, namely, the statement by Sir Josiah Stamp that accountancy conventions lead to a depreciation of stock values, I do not doubt that many of our clients in the last few years would have received Sir Josiah Stamp's doctrine that Stock Exchange fluctuations should be ignored with a good deal of enthusiasm and warmth, especially if they were equally able to convince their Bank Managers that such fluctuations should be ignored. I should like to point a point that it is not so much an accountancy convention or tradition, but a requirement of the lenders—that the original price of the securities by which the loan is fixed is established by reference to the Stock Exchange quotations—that any movement in those quotations must be taken into account. Probably the only way in which fortuitous and (shall I say ?) artificial movements in the value of securities can be overcome would be for security values to be related more to practical continuing business than to the movement of quotations on the various Stock Exchanges of the world.

The other suggestion contained in the paper as to dealing with the whole of the assets of the company, when one is establishing at the end of the financial year its position, raises, as Sir Josiah Stamp stated quite clearly, very grave technical considerations for accountants. I hesitate to contemplate the situation that some accountants would find themselves in if at the end of a year of trade depression they were under the necessity of re-valuing for the certificate purposes the whole of the assets of the company. I think the reaction of the city upon such a proceeding would be indeed noticeable.

It is difficult for a layman to discuss a paper such as we have listened to to-day, especially when, having heard also Professor Gregory, it is clear that there is a wide field of diversion between Sir Josiah Stamp's ideas and Professor Gregory's. The only thing that seems to have the quality of immortality with trade depression is the burden of debt. Whatever else may lose its value, whatever asset may disappear, debts remain. They remain in their monetary expression and they increase with every increase in the depression ; and any fall of costs or any adjustment of costs urged by Professor Gregory merely serves to increase the burden of those debts in so far as they remain unliquidated or unreduced.

I should, through you, Mr. Chairman, like to suggest to the Conference. if I may, with the greatest respect to the learned economists here to-day, that they and we in this country and abroad are endeavouring to solve

and put right and adjust a world economic and financial situation by an international monetary mechanism which is entirely inappropriate to the problem that faces us ; in that all our doubts and hesitations, are in fact inhibitions proceeding from an adherence to an international monetary mechanism which is inappropriate to the new economic situation that faces the civilised world ; in that, however acceptable such ideas, such principles, may have been in the past, dealing with the conditions then existing, it is quite clear, I think, if not indeed to the economists, to the business men of the world that the international monetary mechanism is no longer able to deal with a world which is faced with an entirely new problem. It has been the dream of mankind to achieve abundance, to be freed from the hesitations of insecurity and the doubts of shortage tomorrow or the day after ; and immediately man's inventive capacity and the application of scientific processes produces for the world an age of abundance we find that we do not know how to deal with it—(hear, hear)—and we suggest to the world that, realising the dream of abundance is an illusion, instead of directing our economic agencies, our monetary agencies, our international financial agencies, to the problem of rationalisation, to the organised distribution of this abundance, we are faced with a perfectly amazing situation. The world is seeking to organise scarcity, seeking to diminish abundance, as a solution of the problem of what to do with that abundance. (Applause.)

If I may say so with the greatest of respect, the world has treated economists—a most difficult task, I should be the last to gainsay—with a good deal of toleration during the last three or four years. I am not so sure that they have altogether requited that toleration that they have been shown ; but it is no good now seeking to deal with a world economic problem with most of the world now having become either industrialised or, as Professor Gregory stated, probably would have become in part, industrialised, with international finance, with the national economic policy, the monetary machine with all its clever and beautiful devices seen in contemplation as relating to the conditions which now no longer exist—all that, in my view, has got to be scrapped, and the problem has to be faced from the point of view not of the various excellent and cleverly co-related sections ; the problem has to be faced of how to distribute the increasing abundance that man's inventive agency and control over nature is producing.

I venture to suggest that the adjustment of costs in relation to price and all the other problems sink into significance before that problem,

and for my part I welcome, fraught though it may be with considerable risks and considerable difficulties, the profound experiment that the President of the United States is making in that direction, and I hope, and I believe, if it is allowed to be worked out as it appears to be intended, that it will make a signal contribution to the world solution of these acute problems.

I have just one other point to make in conclusion, Mr. Chairman, and that is on the question of the opposition between personal liberty and economic control. In a civilised world such as we are living in, personal liberty is of very little account if it is not accompanied by economic security. It is of no real good to tell the man on the dole at the Labour Exchange that, although he may be existing with difficulty upon his dole, nevertheless he preserves his personal liberty. It is a very important thing that it should be related also to what is much more important—international economic security and the satisfaction of economic need.

The development of accountancy is an expression of the increasing measure of control over economic forces ; and what the world desires is not less economic control, but, in my view, more economic control. The flower of personal liberty can only flourish, in my view, Mr. Chairman, ladies and gentlemen, in the soil of economic security. (Applause.)

THE CHAIRMAN : The next speaker is Professor J. H. Jones, of Leeds University.

PROFESSOR J. H. JONES : Mr. Chairman, ladies and gentlemen, as I listened to the last speaker I was reminded of the methods employed by our Prime Minister in making public speeches. He first of all makes a peroration and then proceeds to the very ordinary things of life ; then he embarks upon another peroration ; then he returns to the ordinary things of life, and so on *ad infinitum*. I want to return now to some of the ordinary things of life, and I would like to begin by referring to a statement of my distinguished colleague, Professor Gregory, when he said that economists were not agreed upon first principles. I should like to suggest to him that there is a still more fundamental agreement between economists than that, and it is disagreement upon what constitutes first principles. (Laughter.) He said, for example, that we were not agreed upon the way in which we desired prices to behave : whether we wished them to rise or to fall or to do anything else, if anything else is possible. Well, personally, I am not the least concerned how they behave so long as they do behave—(laughter)—and one of the problems that we are faced with at the present time is that prices misbehave. I refer to that because he tried to place

before this meeting a dilemma which exists, in my opinion, only in the minds of a small group of economists who are working at the London School. (Laughter.) In the first place, he tried to convince you of the dangers that attach to the present American policy of controlled reflation. It is the sort of argument that is employed by those people who tried to persuade you to give up wines or other kinds of beverages that you indulge in. The danger of being a moderate drinker is that you will set up your own standard as to what constitutes "moderate." (Laughter.) Then he went on to say that one of the big problems facing the world at the present time, and one in the solution of which the accountants present ought to assist, was to equate the heavy burden of debts with the price level now prevailing in the world. I venture to suggest to him that the American method of controlled reflation, be it successful or not successful, is precisely one of those methods by which it is proposed to secure that equation that he desires; and if we do succeed in raising the world price level, not for the moment, but for a long time to come, then we shall in fact, have gone a great part of the way to solving the burden of fixed debts in various countries at the present time; because those fixed debts are in terms of money, and if you reduce the value of money at the same time you reduce the real burden of those debts.

Now, I venture to submit to Professor Gregory that he should not turn down so easily what is a very serious attempt on the part of a large number of countries in the world at the present time at solving the difficulty that he has placed before you as accountants, and that if he and his colleagues are anxious to prevent any solution along those lines because they believe it will not be a real solution, they should at the same time be constructive and point out real alternatives. It seems to me that the first principle with which Sir Josiah Stamp dealt to-day was the principle of internationalism. The fundamental question that is at issue before the world at the present time is whether we shall divide up into small groups of nations, become competitors to each other, and pursue a policy of economic isolation; and, as an expression of that policy, adopt entirely different currencies which are wholly unrelated to each other; or on the other hand, try to restore the international spirit and the international method of economic organisation that existed and worked so successfully down to 1914; and if I am right in interpreting not only the present paper that has been submitted to us, but also the earlier writings of Sir Josiah Stamp, he himself is entirely in favour of trying to restore internationalism in economic affairs; and there I believe he is entirely

right. If we agree that it is worth while trying to build up the pre-war system in the sense and to the extent that it was an international system, then we ought to try at the same time to restore what was the biggest international influence, and that influence was the Gold Standard. The Gold Standard does ultimately stand for internationalism in human affairs, and the alternatives that have been submitted by Mr. Keynes and other people stand for pure economic nationalism; and it is quite consistent with the attitude of Mr. Keynes on monetary affairs that he should afterwards have developed a very strong sympathy not merely for tariffs, but also for the kind of tariff system that is going to divide the world into more or less isolated compartments. I myself am primarily concerned to see the gold standard restored, in spite of all the difficulties of restoration, and afterwards to maintain the gold standard; because I believe that the gold standard, standing for internationalism in economic affairs, is one of the best guarantees of peace in the world in the future. (Hear, hear.) If that attitude be accepted, then it seems to me that the problem before us is to try and find out why the gold standard was reasonably successful before war broke out, and why it has failed during the last twelve or thirteen years.

As my time is limited and I do not want to trespass on the time of my successor, I cannot, of course, do more than briefly indicate one or two differences that exist between the pre-war world and the world as we have known it during the last ten years, and in that connection I venture to suggest the importance of concentrating upon the condition of affairs of the present year or of last year. We are passing through a period of intense depression, but that depression is the result of a combination of forces that have been in operation for a long time, and it is those forces rather than the manifestations of the depression at the present time that ought to occupy most of our attention. If you go back to pre-war days you will find that there was in operation at that time a gold standard which was the result of slow growth. Because it was of slow growth the various nations adopted or were able to accommodate themselves to the requirements of that gold standard. The prices and costs structure of each of the countries that came on to the gold standard during the last quarter of the nineteenth century had been adjusted to international price level. When we returned to gold after the war we all rushed back to the standard without any prior examination of the differences that had crept in between various nations. It was a shot in the dark, and it was an extremely bad shot. The price levels of various countries were wholly out

of line with each other, and the gold standard of most nations was restored on the assumption that they continued to be in line. They imposed a very severe strain upon the internal industrial structure; and I venture to submit to Sir Josiah Stamp that the failure to maintain the gold standard since 1925 in this country, while it has been due to the difficulty of making our costs and wages respond to the requirements of the standard, itself imposed a strain that no industrial structure ought to be called upon to bear. It is not true to say that wages and prices have been "sticky"; it is not true to say that there have been no fluctuations in the level of wages in this country comparable to those that occurred before war broke out. The fluctuations that have occurred have been greater than at any time during the last eighty or ninety years. The point is that they were not great enough, and they could not be adequate simply because the request which was made was too strong.

Now, that is one difference between the pre-war and the post-war system. There are other differences, to some of which previous speakers have referred—differences in the relation of the industrial structure, the long-term investments, the great accumulation of short funds that before the war would have found themselves in long-term investments and things of that kind. But I would like merely, since my time is limited, just to stress that one important fact which seems to me to be misunderstood in the country at the present time, and that is that the industrial structure of this country, the Trade Union structure of this country, for example, has not been such as to prevent this adjustment in wages and in costs that would be required under the normal working of the gold standard; they have not been sufficient to adapt themselves to those excessive demands that were made upon them by the terms on which the gold standard was restored in 1925. (Applause.)

THE CHAIRMAN: Ladies and gentlemen, our time is really up, but Mr. Cutforth, whose paper comes next, has very kindly said, with the consent of his Chairman, that we may go on for a few minutes, having regard to the great importance of this subject. I will therefore ask the other two speakers if they will kindly take not more than five minutes each.

Mr. C. H. Gooding is the next speaker.

MR. C. H. GOODING, F.L.A.A.: Mr. Chairman, ladies and gentlemen, I will not keep you more than five minutes, and I am not going to attempt to follow the learned professors into the monetary affairs of the old world, and Alderman Latham into his very interesting outlook on the new world. What I do want to direct your attention a little bit to is something which

the other speakers have not emphasised, and that is more the psychological side of this problem to which Sir Josiah Stamp has directed our attention. You may not have noticed it in the intricacies of the many other problems, but I think it is of great importance because if we are to tackle those long-range problems which Sir Josiah Stamp mentioned, then I think we have to get another type of people to attend our Conferences. One would wish that this paper had been sent to the Conference which is sitting in another place ; because, while it might not have made them talk more, I think they would have thought more.

I think you will admit that we are not likely to receive consideration of long-range problems, or even short-range problems, from those responsible Ministers who are in power this year, and maybe next year. It is not in human nature that that sort of thing could be done, and my point is, first of all, that we are sending the wrong people to our Conferences. The true guides should be the great economists of all the nations that belong not to one nation but to all nations, and those are the people, I think, who would get us in the right direction.

Sir Josiah Stamp says this on page 28 : " The problem of exchange in international finance is in the long run, whether we can secure by a single mechanism stability of price measurement. . . ." Otherwise, if we do not, it appears we are going to slip down the slippery slope with slipping prices ; and if we are going to continue in world trade, then we have to do something in this way to consider and stabilise monetary problems ; otherwise, we are going to have a different sort of world.

There is another point to which I would direct your attention. On page 45 Sir Josiah Stamp says : " . . . we have not yet made up our minds what kind of a world we really desire to live in." What is that world ? Either we must have a world trade or else we must go back to a sort of world which Mr. G. K. Chesterton would probably call blessed, where every man in town has his little workshop and his little loom, and every man in the country, I suppose, has three acres and one cow, unless someone wanted two cows, and then we should start the row all over again.

Responsible Ministers, as I think we have seen during the last few weeks discussing financial problems, is something which no man apparently can face with equanimity. Therefore someone else has to do the task. Then these responsible Ministers are governed to a very great extent by the public opinion of their own countries, which is often wrong-

headed, certainly one-sided, and an opinion which is often based purely on emotion and not on common sense or experience at all. Must we go on saying "Hush!" every time that responsible Ministers have to discuss responsible questions upon which our economic life exists? I think not. Is there no way out? Should not we press upon our Governments to set up a Conference, a permanent Conference if you like, until we arrive at years of discretion; a Conference which would enable us to be taught to think in the way we should—internationally? And then we might act nationally.

Sir Josiah Stamp says in another part of his paper: "Nothing is good or bad, but thinking makes it so." Now, I believe that a Conference of international experts would teach us how to think. In that case we should learn how to act, and then we should learn to see a thing and see this monetary question and see the world with all its problems as a whole. That does not mean that we should just see the other fellow's point of view; because when we see the other fellow's point of view we often dislike it; but I believe that if we could get such an Economic Conference composed not of Ministers, not of delegates from the political Governments of their countries, but of Ministers who would be able to judge these things from their scientific knowledge—if they could continually report to us, then I think we should get a way of internationally thinking and see a way out of our troubles that are weighing on us to-day, and which international conferences are hopeless to settle. I believe that accountants must do this; we cannot rely upon newspaper editors—newspaper editors only fiddle while the world in which their readers live is burning. It is for accountants to do this. The Congress that can devise some plan which will lift us out of the troubles that we are now in will make a name for itself. Now, might not this Accountancy Conference, by its resolves, by its discussions, seek to bring to bear upon the people the necessity for expert, and continuous expert, advice and guidance? If we do that, then perhaps this Congress will make a name for itself. (Applause.)

MONS. DE REGT (Holland): The Chairman has kindly consented to allow me to bring before this large gathering my observations on a matter which can well be brought forward at such an important Congress as this.

Now, the World Economic Conference, although disagreeing on many points, did come to a general conclusion that something was needed to bring the nations into closer relationship for the purpose of world trade.

It is with this in view that my remarks are to be given.

Now, each country is endeavouring to safeguard its own trade. There

is, however, trade which they *must* do with other countries.

Assuming, therefore, that the point is reached whereby this safeguarding is provided for, there must be a means of buying or selling goods or commodities, which must be paid for.

What is this means to be? It must have a value, and a value which will be recognised by each member of the world community.

The means in my opinion could follow a line based on a unit, so long as this unit can be made agreeable to the nations.

The unit could be named "Kilo-Gold," with its various subdivisions of the metric system. This could represent one kilogram fine gold.

Once this basis is established the operation of the method could first come by having a world circulation bank for the express purpose of putting into circulation this unit as an international medium of exchange.

The founders of the world circulation bank would be all the existing national circulation banks of the world, such as—

The Bank of England,
The Bank of France,
The Nederland Bank,
The Federal Reserve Bank, &c.

These National Banks would in their own countries act as branches of the World Circulation Bank.

Now to describe the operations. Before doing this I would like to say that at the World Economic Conference Monetary Committee it was unanimously agreed that gold itself was not necessary for the *internal* means of exchange.

The system which I am about to explain will work on this principle.

Now gold not being necessary, the banks could deposit their holdings of gold with the World Circulation Bank. It would, of course, only be necessary to earmark this gold-holding and keep it in their own lockers.

In exchange for this gold they will receive from the World Circulation Bank gold notes at the value of kilo-gold, the effect being that the World Circulation Bank would be the clearinghouse for international transactions.

These gold notes are thereby covered by gold up to 100 per cent. This will mean that a trader desiring to pay for goods will do so by means of gold notes, which he will get from his own national bank by way of the currency of his own country, and thereby obviating fluctuations of so many foreign exchanges.

Goods for sale will, therefore, in foreign trade, be quoted at a price in kilo-gold.

The larger aspect of the case would lead us to visualise the easy method of expansion of world trade which depends on the freer circulation of gold. There may be a surplus of gold notes in one country beyond its immediate needs, and therefore this could be utilised by another country, and so develop freer trade between the nations.

Coming next to the vexed question of silver, it is my opinion that a fixed ratio to gold could be agreed upon, say 1-16, and thus enable countries dealing largely on a silver standard to come into line with the gold-note system.

This would also operate favourably for an expansion of circulation.

I would like the members of the Congress to reflect on this subject as my contribution at so important a gathering as this, towards a means of world recovery.

THE CHAIRMAN : The next speaker is Mr. E. Cassleton Elliott.

MR. E. CASSLETON ELLIOTT, F.S.A.A. : Mr. Chairman, ladies and gentlemen, we thank Sir Josiah Stamp for his interesting paper, and I should like to express our thanks to him and to the leading economists who have been here to-day for their services to mankind. I think you will find that the newspapers are very fond of chaffing economists, but in my view they are serving a very useful purpose, their aim and object being the greatest good for the greatest number. Economists may differ, but I have Professor Gregory's word for it that on balance he is in agreement with Sir Josiah Stamp this morning. Professor Jones does not seem to be quite in agreement, but, at the same time, I am quite satisfied that they all require the betterment of mankind.

So far as Sir Josiah Stamp's paper is concerned, as you know we had no time really to study it ; we could only scan it ; and I would like just to refer for a few moments to such portions of the paper which interest us as accountants. He says that we are hidebound by conventions. It is perfectly true that we are. Ever since Noah went into the Ark and took his animals with him two by two, we have learnt to count by numbers. Sir Josiah Stamp has mentioned this morning boots. I fail to see how we can measure everything by units of boots, or units of any other commodity. When we want to exchange our boots for a cow—to which the last speaker referred—we shall want a unit to know exactly how many pairs of boots are worth one cow ! What better unit could we have than the one which has been in use for so many centuries, and in use effectively ? I fail to see how we can better that. We did not adopt that unit ; it came to us as accountants a few years ago—because, after all, the accountant's

profession is a very young profession. At the same time, we shall be only too pleased, I have not the slightest doubt, to receive from Sir Josiah Stamp some other method of counting and some other method of calculation so long as it is equally or more effective.

Now, so far as writing up and down fixed assets is concerned, as accountants and auditors our troubles are quite sufficient as they are, and I think you will agree that if assets are to be revalued every time we draw up a balance sheet our position will be intolerable. Shareholders, of course, too, will be misled, and no one will know exactly where they are. After all, accountancy is a precise science. It may be, of course, that we are wrong, in Sir Josiah Stamp's view, in considering it a precise science ; but if it was not precise I fail to see what use accountants are, or what use accountants would be ; and therefore I most definitely am not going to agree with him, because we should find ourselves without clients and with nothing to do. I do not propose as an accountant to leave everything to the economists, great as my admiration is for them.

There is one other final word, and that is in regard to the excessive profits made when prices are rising. As prudent accountants we always suggest, when excessive profits are made, if our advice is asked by the directors, that a substantial portion should be placed to reserve. Then, of course, we are asked our reasons, and we say that it is wise to place something to reserve for future times of adversity. But I am afraid that here we are not quite so consistent ; because when those adverse times come it may only be an April shower and we are rather inclined to say : " After all is said and done, we think you had better retain that reserve and not utilise it, because later a hurricane may come when you will require it more than you do now." There, sometimes, we find ourselves in disagreement with the directors ; but, after all, our advice is for the benefit of the business. I should like to hear what Sir Josiah Stamp has to say to that—as to how one is to divide up reserves which have been made in times of prosperity, and the measure one is to use to divide them in times of adversity.

We are very grateful to all these economists who have spoken to us. We appreciate all they say, and we are quite satisfied in our own minds that they are here for the benefit of mankind, not for their own benefit ; they are seeking to do something which we all wish, and that is in this world of plenty to see how the plenty can be divided amongst the populations of the world. (Applause.)

THE CHAIRMAN : Ladies and gentlemen, I am sure you would like

Sir Josiah Stamp to reply in a few words. (Hear, hear.)

SIR JOSIAH STAMP, in reply to the discussion, said : Mr. Chairman, ladies and gentlemen, I have listened to the contributions to this discussion with very great interest. I can only reply to one or two points.

It is quite true, as Professor Gregory says, that on certain questions there is a considerable divergence of view, but upon the principles underlying this paper there seems to me to be a very small difference indeed. We are all of us trying to find that blend of nationalism and internationalism, of liberty and control, which will give us the best system ; and I say it is for economists to show the kind of world that people want, rather than always to prescribe that world. When the worthy Alderman says he has had a good deal of admiration for economists in the past two years, admiration for what ? The job of the economist is to try to show what the consequences of certain actions on the part of the business world will be. When the business world behaves so inconsequentially as it has in the last three or four years, it then turns round upon its guardians, the economists, and says : " Why do not you take better care of me ? " (Laughter.) If the business world will say more definitely how they want to behave in particular circumstances, then the economists can tell them within a fair degree of accuracy and agreement what will be the result. You have only to see the enormous divergence of opinion amongst business men in the United States and here, where some want business to be entirely free, and others are prepared to subscribe to the Industrial Recovery Act, to see how difficult it is for the economists to get the material on which to form a judgment. Alderman Latham says that what we want are not the things we have been discussing at all ; that is all beside the mark ; we want to be able to distribute the world's abundance. Really he is calling the same thing by another name. When we say we want costs and prices to be in relation to each other, that is only because we want to be able to distribute goods ; and if they are not in relation to each other, goods will not be distributed. It is just as if we had been discussing a paper this morning on whether certain foods were better than others, and the relation between the foods, and the alderman getting up and saying : " Away with all these things ; what we want is health." (Laughter.) Then he says we are not really discussing liberty ; what we are discussing is economic security. I think that there, again, he is calling the same thing by another name. You can be so secure that you cannot move, as in prison. (Laughter.) You can be so free that your freedom is no good to you, as in the permission tacitly given to everyone in a theatre to leave

by a certain door whenever they like ; so they can ; but if they all try to do it at once no one can do it at all. (Laughter.) Therefore, you see, he is really taking the *amalgam* we are seeking and saying : “ That is the thing we want.” Well, we have said so. He has not got down to the essence of my paper.

Then we were told by another speaker that accountancy is a precise or exact science. All right. You are trying to be exact and precise with your accounts, and you have invented certain rules which have been excellent. All I have said is that those rules may have been excellent, but it is the duty of you to say : “ Here are certain things which we have been accustomed to regard in the past as relatively fixed. They are moving all over the place. Can we find any better way than we have in the past of representing those in a precise way ? ” I am asking you to be *more* precise. I ask you to invent a new kind of precision which will bring anarchy under some kind of control. Nothing that the speaker said gets away from the fact that you are—whether you can dispose of them or not, I do not know—exaggerating the effects of the trade cycle and the psychology leading to it.

Then there was an interesting reference to the position of accountants when he spoke of Noah and the animals. You remember that Noah was shooing the animals out of the Ark two by two, and saying to them in a helpful spirit, “ Now, get out, be fruitful and multiply ” ; and when he thought the Ark was empty he looked round and saw that it was not cleared, because in one corner there were two little snakes. He scolded them and said, “ Get out ! Be fruitful and multiply ” ; and they said “ We cannot ; we’re adders.” (Laughter.) That is just what I have asked the accountants to do to-day, to be fruitful and multiply, and the answer that I get is : “ We cannot ; we’re adders.” (Applause.)

THE CHAIRMAN : Before I leave the chair, ladies and gentlemen, I am sure you would like to express your thanks to Sir Josiah Stamp for his splendid address ; and not only to Sir Josiah Stamp, but I am sure you would wish me to thank all the speakers. Not among the least of the achievements of your executive is the production of Sir Josiah Stamp on this platform. I may say that we chased him to Chicago, where he was showing our American cousins that British railway enterprise is not dead. (Applause.)

TUESDAY, 18th JULY, 1933

Morning Session

CHAIRMAN: MONS. E. VAN DIEN (Holland).

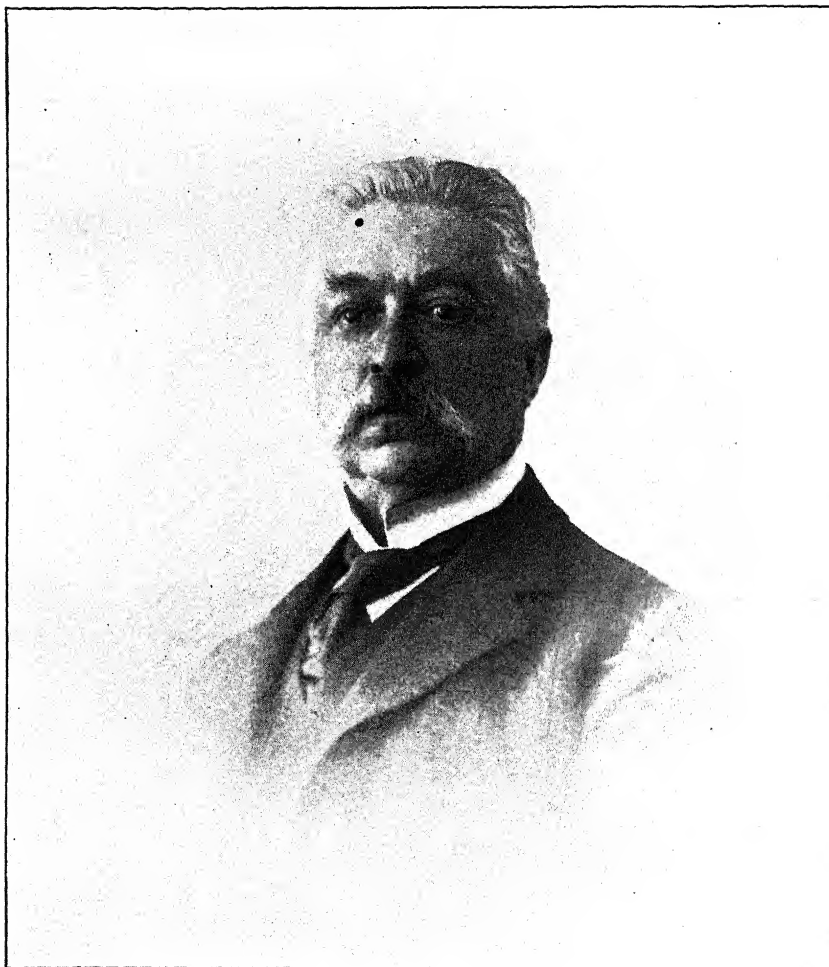
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PAPER

“Exchange Fluctuations in relation to Accounting
as regards Operating Results and Asset Values”

MR. A. E. CUTFORTH, C.B.E., F.C.A.



MONSIEUR E. VAN DIEN, F.S.A.A. (HON.) [Photo by Canleur]
President of
the Second International Congress on Accounting, 1926

EXCHANGE FLUCTUATIONS IN RELATION TO ACCOUNTING AS REGARDS OPERATING RESULTS AND ASSET VALUES

BY

A. E. CUTFORTH, C.B.E., F.C.A.

I. INTRODUCTION

There are few items of public information which remind us more vividly or more frequently of the economic vicissitudes to which the various countries of the world are subject from time to time than the quoted rates of exchange—in other words, the relative values of the currencies of the different countries.

The disadvantages of a currency not fixed by some more or less universal standard, such as that of gold, have always been recognised by students of economics and also by financiers, traders and others who are brought into frequent touch with the practical aspects of the question.

For a number of years prior to the great war the general tendency was towards the stabilisation of the exchanges ; and it seemed likely that at no very distant time the currencies of nearly all the civilised nations of the world would to all intents and purposes become fixed as between each other ; in other words, that the variations would be so slight as to cause little or no inconvenience to the flow of international trade and incidentally to present no difficulties to the accountant.

Effect of the Great War on Currencies.

The outbreak of the European war profoundly altered this situation. Financial transactions between enemies immediately ceased. As regards other channels of trade and finance, some were stimulated, some were diverted, and others were destroyed alto-

gether. The belligerent nations borrowed money to the best of their ability, firstly from their own nationals, and then, so far as they were in a position to do so, from other nations. The money so borrowed may be said to have been blown into the air, destroying lives and property in the process. Small wonder was it, therefore, when at last the struggle came to an end, that the exchanges were in a chaotic condition. Nor was it easy to create new standards with any firm expectation that they would prove permanent. The unsolved problems of the settlement of inter-ally debts and of reparations, with their repercussion not merely upon the finances of the nations concerned, but upon the trading operations of their peoples with each other and with third parties, obscured the horizon. Added to this, political disturbances hindered, in many countries, the return to ordered progress.

And to-day, nearly fifteen years after the cessation of hostilities, there seems little prospect of the currencies of the chief countries of the world being stabilised in their relation to each other in the near future. Accountants therefore must be prepared for some long time to come to record or to verify from accounting records transactions taking place in fluctuating currencies.

Assumption in regard to the currency in which Balance Sheets and Profit and Loss Accounts are submitted.

The first axiom which will, I suppose, be universally admitted is that the statements of account showing the position of any business, i.e. the balance sheet and the revenue account or profit and loss account, must be presented in terms of the currency of the country where the owners of that business are domiciled. For example, a public corporation in the United States of America may own a number of public utility undertakings in South America. The detailed records of these various enterprises, kept in South America, will, of course, appear in the local books of account in the currencies of the countries where such enterprises are situated, as the local transactions take place in those currencies. But the annual balance sheets and profit and loss accounts which would require to be furnished to the shareholders in the United States of America if presented in terms of, say, Brazilian milreis or Argentine pesos,

would probably be unintelligible to the proprietors who received them, or, what is worse, misleading. It therefore follows that while the transactions in foreign countries—and the term “foreign” is used as meaning countries other than that where the owners of a business are domiciled—have to be recorded in the local currency in which they take place, the system of accountancy must be such as will enable a proper picture, showing the state of the affairs of the business, to be presented at regular intervals in terms of the currency of the home country.

As has been noted, the owner of a business naturally looks at transactions in the light of the currency of his own country. In other words, he instinctively tries to convert, in his mind, transactions in a foreign currency to their equivalent in terms of the currency of his own country. Such a man is therefore apt to regard the currency of his own country as being the stable currency and the currencies of foreign countries with which he does business as fluctuating currencies. Great Britain departed from the gold standard in the autumn of 1931, and the United States of America departed from the gold standard in the spring of this year, 1933. In 1932, therefore, the currency of the United States was fixed in relation to gold whereas the currency of Great Britain was a fluctuating one. But the Englishman in 1932 would still require the accounts of businesses in which he is interested to be presented in terms of sterling, and would take no cognisance of the fact that the pound sterling was no longer linked to gold. An English farmer, with a predilection towards keeping a reserve of cash in his house, may have had stored away in 1930 fifty golden sovereigns. Early in 1931 he may have expended thirty of these on the purchase of a cow. The remaining twenty were only brought from their hiding place in 1932, when they were required for the purchase of another cow. The farmer knew that these twenty sovereigns no longer formed part of the currency of his country, but that he could sell them to a dealer in gold in exchange for currency. He did so, and they realised, let it be assumed, £26, with which he bought another cow. What have his two cows cost him? Before he bought his first cow he possessed currency (represented at that time by golden sovereigns) amounting

to £50. After he had completed in 1932 the purchase of his second cow he had exhausted his funds and had in their place two cows. If he thought in terms of gold he would say that his two cows had cost him £50. But if he thinks—as the ordinary man would do—in terms of currency, he would say that his two cows had cost him £56, and that the excess of this sum over the £50 which he had in 1930, namely £6, represented a profit on the realisation of the twenty gold sovereigns in 1932. His books of account have certainly to be kept in terms of the currency of his country ; and they should therefore record the first cow as having cost him £30 and the second cow £26.

Assumption that Accounting Records are concerned with at least Two Currencies.

It is perhaps unnecessary to mention that when one is referring to the treatment of fluctuating currency in accounts, one has not in mind the cases where the transactions are taking place and the accounts are kept wholly in one country, although such country's currency may be a fluctuating one when measured by a gold standard. One is considering the case of where two or more countries are concerned, and where the values of the currencies fluctuate in relation to each other. And, for the reasons already given, one has to proceed on the assumption that the currency of the country in which the owners of the business are domiciled is, for book-keeping purposes, to be deemed to be the fixed currency, and the currencies of the other countries with which or in which transactions are taking place as the fluctuating currencies.

II. MAIN PRINCIPLES OF CURRENCY CONVERSIONS FOR PURPOSES OF THE BALANCE SHEET AND THE PROFIT AND LOSS ACCOUNT

Textbooks which deal with the treatment of a fluctuating currency in accounts lay down the following four main principles in regard to the preparation of a balance sheet and a profit and loss account in terms of a fixed currency :—

- (i) that capital expenditure, incurred in fluctuating currency, should be converted into the fixed currency at the rate of exchange prevailing when the expenditure was incurred.

- (ii) that floating assets (other than stocks) and liabilities in the fluctuating currency should be converted into the fixed currency at the rate of exchange prevailing on the date as at which the balance sheet is drawn up.
- (iii) that stocks of goods in hand at the date of the balance sheet, which have been purchased in the fluctuating currency, should be converted into the fixed currency at the rates of exchange prevailing at the times when they were acquired. Goods purchased for re-sale should be written down to market value if such is less than their cost.
- (iv) that profits earned in a fluctuating currency must be converted into fixed currency at the average rate of exchange prevailing during the time when the profits were earned. The same principle would, of course, apply in regard to losses.

As will be appreciated, a number of points of interest and importance arise in practice in the application of the foregoing principles ; and it will be convenient to group them under the four heads set out above.

III. CAPITAL EXPENDITURE

Firstly then, there can be considered questions incidental to the recording of capital expenditure.

Composition of Capital Expenditure.

Speaking in general terms, capital expenditure may be said to be composed firstly of wages, secondly of materials, and thirdly of a number of administrative and other charges incurred on capital account. One is speaking, of course, of cases where a business or undertaking carries out its own capital expenditure, and not of cases where the expenditure is placed in the hands of a contractor, or of cases where fixed assets are bought in a complete state, as, for example, a works or a factory.

Wages paid on Capital Account.

For the purpose of ascertaining the equivalent, in terms of the fixed currency, of the wages paid in the fluctuating currency on capital account, it is the usual practice to convert the monthly

totals of the wages at the average of the daily rates of exchange prevailing during the month, or in cases where the fluctuating currency does not vary very greatly in value, to convert the totals quarterly, half-yearly, or yearly. The choice between dealing with the totals at short or at longer intervals depends firstly on the extent of the variations in the value of the currency, and secondly on the question of whether the capital expenditure is being incurred more or less evenly over a financial period or whether it is much heavier in some months than in others. In case of doubt it is preferable to choose the shorter periods, as this procedure, while entailing a little more work and trouble, certainly yields the more accurate results. One may take as an example the case of an English company owning a railway system in the Argentine Republic. During a particular financial year the average rate of exchange, let it be assumed, has been such that twelve Argentine paper pesos have been equivalent to £1 sterling. A capital expenditure programme has been in progress throughout the year, and the total capital expenditure on wages during the year has amounted to 6,000 pesos. The conversion of 6,000 pesos into sterling at the rate of 12 pesos to the £ gives a sterling equivalent of £500. But on closer examination it is ascertained firstly that of the 6,000 pesos no less than 5,000 were expended during the first month of the year, and also that during that month 10 pesos were worth £1 sterling. Obviously, there should be attributed to these 5,000 pesos a rate of 10 pesos to the £, instead of the average rate of the year. 5,000 pesos at the rate of 10 pesos to the £ equal £500, while at the rate of 12 pesos to the £ they only equal about £417. The basis of applying to the 5,000 pesos the average rate of exchange applicable to the year would therefore result in the capital account being undercharged by about £83; and the case clearly calls for the conversion of monthly totals at the average monthly rates of exchange. It will, of course, be realised that the conversion of the totals of even so short a period as a month at the average monthly rate of exchange does not achieve absolute accuracy. If absolute accuracy were sought to be secured, then presumably the conversion of the wages applicable to each day should be made at the rate of exchange of that day. But the

accountancy system is the servant and not the master of a business, and no accountant would go so far as to suggest that the extra work involved in the daily conversions was a reasonable price to pay for the extra degree of accuracy obtained.

As will be explained later, the application of inappropriate rates of exchange for the purpose of making conversions from one currency to another for bookkeeping purposes does not always perpetuate an error; the error may be automatically adjusted in the same or in the next financial period. This does not, however, apply where capital expenditure is concerned. An over debit, or an under debit to a capital expenditure account creates an incorrect figure which remains on the books in perpetuity—except, of course, to the extent to which it may gradually be reduced from year to year by the writing off of depreciation or be removed by the sale of the asset. It will be appreciated also that an overcharge or undercharge to capital account automatically entails an overstatement or an understatement of profits.

Occasionally specious arguments are put forward, in perfectly good faith, in support of a departure, in certain circumstances, from the generally accepted principle in regard to the conversion of capital expenditure. For example, the Argentine currency was at one time, practically speaking, fixed in relation to English currency on a basis which gave to the Argentine paper peso a value of about rs. 9d. The subsequent decline in value of the Argentine currency (the rate in February 1933 was about rs. 6d.) did not cause a proportionate rise in prices in the Argentine expressed in Argentine pesos. For the purposes of this illustration let it be assumed that there had been no rise at all in the rates of wages in the Argentine, expressed in Argentine pesos. An English company may have been engaged on a capital expenditure programme necessitating the disbursement of a considerable sum in local wages, and this work may have been in progress during the time when the Argentine exchange began to fall. The directors of such a company may conceivably say to themselves: "For every 100 pesos which are being spent on labour, just as much work is being done as was the case before the Argentine currency fell in value in relation to sterling.

For a number of years past we have converted the Argentine currency into sterling for the purpose of our capital expenditure and other accounts at the par rate of exchange. When judged by that standard, the capital expenditure incurred in currency is still worth par to us, and we propose to continue to convert it at par." A little reflection will show the fallacy of such an argument. In the first place, capital expenditure is not recorded in books of account at what the parties interested may think is its real value to them ; it is recorded on the basis of what it actually cost. In the case under consideration, the expenditure incurred when the Argentine peso fell in value became, when expressed in sterling, correspondingly lighter. The same number of pesos may, it is true, have purchased the same amount of labour as before, but from the standpoint of sterling the cost was less. In the second place the pesos so spent were in liquid form : not improbably they formed part of a currency bank balance. Had they still been in that state when the balance sheet was prepared, they would have been valued, in common with other currency floating assets, on the basis of the rate of exchange prevalent at that date ; that is to say, at a rate considerably under par. The fact that they have been converted from a floating asset into a fixed asset, namely from cash at bankers to capital expenditure, is no justification for attributing to them any higher sterling equivalent than the equivalent at the time when they were spent. Indeed, to attribute such higher value to them is tantamount, as has already been mentioned, to overstating profits : in other words, an overcharge to capital account, involves an undercharge or an over-credit to revenue account.

Profits and losses on currency floating assets and liabilities incidental to capital expenditure.

Difficult questions sometimes arise in connection with exchange profits and losses on currency floating assets and liabilities which are incidental to a capital expenditure programme. There is firstly the question of principle, that is to say, whether such exchange profits or losses should be credited or debited to capital account, or whether they should be taken to profit and loss account.

For example, it occasionally happens that considerable liquid resources are specially accumulated in the fluctuating currency preparatory to being spent on capital account. These funds, which are probably represented by cash at bankers, increase or decline in value as the rate of exchange fluctuates ; and it may be that they are of considerably less value at the time when they are expended than at the time when they were first accumulated. It would seem reasonable, in view of the fact that these liquid resources did not form any part of the floating capital necessary for the carrying on of the business or undertaking—that is to say, for its maintenance or operation—but were definitely earmarked for capital purposes, that any loss occurring owing to a decline in the rate of exchange between the time when they were accumulated and the time when they were expended, should be debited to capital account as being incidental to the capital expenditure programme and in no way connected with the revenue account. On the other hand, those responsible for the preparation of the periodical accounts of such a business or undertaking might well decide that in spite of the justification for the charging of such a loss to capital account, it would be preferable, as a measure of financial prudence, to write it off to revenue account, in order that the charges to capital account may be limited to the actual cost of the fixed assets acquired or constructed, and shall not contain any losses of floating capital, although such losses may be incidental to the capital expenditure programme, and quite unconnected with revenue.

In considering the above question it is of interest to bear in mind the legal interpretation of “ profits available for dividend.” One is speaking now, of course, of the position from the point of view of the law of England. The legislature has carefully avoided attempting to define “ profits ” and those of us who, as practising Accountants, are brought almost daily into touch with the practical aspects of the question, realise that a satisfactory definition is an impossibility. In specific cases, however, which have come before the English courts for decision, certain principles have been indicated by the judges : and one of these principles is to the effect that in arriving at profits available for dividend, losses of floating or circu-

lating capital must be made good but that losses of fixed capital need not necessarily be made good. So far as its form is concerned, cash accumulated at bankers with a view to its subsequent expenditure on capital account is clearly floating capital. But it is not floating capital in the sense that it is necessary for the ordinary carrying on of the business and is being used for that purpose. It appears to the writer therefore, that the dicta of the judges referred to above cannot be regarded as implying that, under all circumstances, exchange losses on floating capital which is destined to be converted into fixed capital must be written off to profit and loss account.

It seems difficult to say more than that :—

- (a) each case must be judged on its own merits,
- (b) in cases where the arguments both pro and con seem to be equally strong, it is well to err on the safe side. That is to say, that if there is a loss it should be written off to revenue account, and if a profit it should be taken to the credit of capital account, and
- (c) if a loss on exchange is debited to capital account this should be shown separately in any statement of accounts and not included as part of the actual cost of the fixed assets : similarly, a credit to capital account should be shown separately.

As will be appreciated there is an alternative course in appropriate cases which, in a sense, combines the two methods of treatment, and that is to hold up the loss in suspense on the assets side of the balance sheet temporarily and then to write it off to profit and loss account over a series of years.

A not altogether dissimilar situation, in principle, arises where, in order to pay for capital expenditure incurred in a country whose currency fluctuates, a loan is raised from a bank in that country. If, subsequent to the time when the loan is raised, the currency appreciates in value, there is a corresponding increase in the amount of the liability ; and as the liability had been expressly incurred for capital purposes it might be argued that instead of the loss arising from the increase in this liability being written off to profit and loss account, it should be charged to capital account as being

incidental to the capital expenditure. It is submitted, however, that this principle is not one which would find acceptance among accountants.

A case arose not long ago where a company domiciled in England but engaged in business in the Union of South Africa, raised a loan (of a permanent nature) in South Africa, and purchased premises with the proceeds. At that time the currencies of both England and South Africa were on the gold basis, and therefore the South African pound was considered as being equivalent to the English pound. Consequently in the balance sheet (exhibited in England) the transaction (using hypothetical figures) appeared thus :—

Loan account ..	£100,000	Cost of premises ..	£100,000
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When, however, Great Britain departed from the gold standard, but the Union of South Africa still adhered to the gold standard, the English pound could no longer be treated as equivalent to the South African pound. In fact, four South African pounds became worth about five English pounds.

Consequently when the next balance sheet required to be prepared in England, expressed in sterling, it appeared as follows :—

Loan account ..	£125,000	Cost of premises ..	£100,000
		Loss on exchange in connection with loan of £100,000 in South African pounds ..	25,000
	<u>£125,000</u>		<u>£125,000</u>

The above is an instance of where a loss on exchange arose in connection with the acquisition of a fixed asset, and had nothing whatever to do with the ordinary operating results of the business : yet no accountant, it is suggested, would be found to declare that the loss was one which could be carried to capital account.

Another argument which is occasionally heard in support of the capitalisation of a loss incurred on floating capital in circumstances similar to those outlined is that if the owners of the undertaking had not carried out the capital expenditure programme themselves but had made an arrangement for a contractor to undertake it at

a fixed price, that contractor would probably have had to provide liquid funds in the fluctuating currency somewhat in advance of the time when he required to spend them, or, alternatively, that he would have had to incur liabilities in the fluctuating currency ; and that in view of the possible losses which he might conceivably have to incur by reason of variations in the rates of exchange he would increase his contract price. In such an event the owners of the undertaking would have charged the whole contract price to capital account, although it would have included a reserve for possible losses on exchange, and also presumably an amount representing the contractor's profit. The answer to such an argument, of course, is that the books must deal with the transactions in the form in which they actually occurred ; and that the fact that under different circumstances capital would have been charged with a larger sum and revenue relieved of a certain amount of loss has no bearing on the matter whatever.

Quite apart, however, from the difficulties of laying down a fixed principle, there are frequently difficulties in the application of a principle. In the examples quoted above, it is easy to earmark a loss as being incidental to capital expenditure ; but in other cases in actual practice it may be quite difficult to earmark, beyond dispute, a loss as being attributable to capital. And this practical difficulty strengthens the argument, in such instances, for writing the loss off to revenue account.

Materials used for capital purposes.

In so far as capital expenditure is composed of the use of materials, these may consist of materials purchased in the fluctuating currency of the country where the capital expenditure programme is being carried out or of materials imported from the country having the fixed currency. As regards the stores purchased locally it is essential to ascertain the value of these, expressed in terms of the fixed currency, at the time when they were purchased, for such value expresses their cost, and it is at their cost price that they require to be embodied in the capital expenditure account in the books. Further reference will be made to the question of stores in general

later. As regards stores purchased in the fixed currency, no such difficulty arises.

Miscellaneous expenses incurred in currency on capital account.

With respect to items other than wages and materials which can enter into the composition of capital expenditure, it is perhaps unnecessary to make any comments except to mention that so far as the charges represent expenditure in the fluctuating currency they require to be converted into the fixed currency at the rate of exchange prevailing at the time when the expenditure was incurred. In actual practice this may be achieved by dealing with totals monthly, quarterly, half-yearly or yearly, as may be appropriate, and converting these totals at the average rate of exchange of the month, quarter, half-year or year.

Capital expenditure usually transferred to head office books.

Before leaving the subject of capital expenditure it should be mentioned that it is usually found most convenient, in the case of a business owned and controlled by parties in one country but operating in a country where the currency fluctuates, to transfer the capital expenditure accounts from the local books to the head office books, in which latter books the expenditure is, of course, recorded in the currency of the country where the ownership and control exists. The reason for this is that such expenditure is not subsequently affected by any fluctuations in the exchange. As and when, in the course of each financial year, new capital expenditure is incurred, or any fixed assets are sold or scrapped, the necessary information is furnished by the local office to enable the appropriate entries to be made in the books of the head office where the capital expenditure accounts are recorded.

Provision for depreciation or replacement of fixed assets.

Special points of importance sometimes arise in connection with the provision for depreciation of fixed assets which are in use in the country having the fluctuating currency.

It is to be noted that just as the fixed asset accounts are recorded in terms of the fixed currency, the reserves for depreciation of such assets require to be dealt with in a similar manner. For example, let it be assumed that a fixed asset, say some machinery, was

purchased for 100,000 Argentine paper pesos, and that it was thought necessary to make such a provision for depreciation as would amortise the cost of the asset in 20 years. It might seem at first sight* as if this result could be achieved by debiting to profit and loss account each year for 20 years a sum of 5,000 Argentine paper pesos. Let it be presumed that at the time when the expenditure was incurred, the Argentine peso was worth 1s. 9d. The sterling equivalent of the expenditure would be £8,750. If during the 20 years the Argentine peso stood on average at the rate of 1s. 6d., it is clear that the depreciation reserve account, accumulated during the 20 years, would only amount at the end of that time to £7,500 ; in other words, it would be insufficient to amortise the cost of the asset at the end of its assumed economic life. It will therefore be realised that in order to maintain the depreciation fund on a proper basis, it will be necessary to charge, in arriving at the local profits of the business in each of the 20 years, such a number of Argentine pesos as at the average rate of exchange prevailing during such year gives a sterling equivalent of £437 10s.

The following matter may also be of importance in connection with provis. on for depreciation or renewal of fixed assets.

In most classes of undertaking it is customary to provide such a sum for depreciation as will write off the cost of a fixed asset by the time that the economic life of such asset has expired. Then, when another asset is purchased to take its place, the cost of the new asset is charged to capital account. The new asset, let it be presumed, is identical with the old : but it may cost less than the old asset originally cost, or it may cost more, as price levels may have changed considerably since the time when the old asset was acquired.

In some classes of undertaking, however, particularly in what are known as public utility undertakings such as railways, it is customary to allow the cost of the fixed assets acquired or constructed to remain permanently on the capital account and not to write off any depreciation ; but to build up, by charges in the annual revenue account, a renewal fund, and then when the asset wears out and requires to be replaced by another similar asset, to charge the cost of the new asset against the renewal fund, irrespective of whether

the new asset costs less or costs more than the asset which it has replaced. In deciding, therefore, what annual sums are necessary to be charged to profit and loss account and to be credited to the renewal fund in order that the renewal fund may be adequate for the purposes for which it was created, it is necessary to have regard to the probable cost of replacing the existing assets and not to the cost of the assets which are to be replaced. This aspect of the matter may be of considerable importance if the expenditure upon the original asset and also the expenditure necessary in order to renew that asset are in a currency which has fluctuated considerably in the past and may conceivably fluctuate considerably in the future. For example, a railway undertaking will have in its capital account the original cost of the rails, sleepers, &c., comprising its permanent way (i.e. its track) and such cost will include the labour costs of laying the rails and sleepers. These labour costs will be paid in the currency of the country ; and, if the currency of that country is subject to wide fluctuations it may well be the case that the daily pay of a labourer engaged in the work of taking up old rails and sleepers and putting down new ones in their place, when converted into terms of the fixed currency (as would be necessary for accountancy purposes) is very different at the time when the renewing takes place from what it was when the rails and sleepers were originally laid down. If such is the case it may be necessary to modify the annual sums debited to revenue account and credited to the renewals fund in order to meet the anticipated costs of replacement.

While referring to provisions for depreciation, whether created in order to write down the original cost of the assets or whether carried to a renewal fund to provide for the cost of renewing the asset, it should be mentioned that it is usually found most convenient to keep any balances on these accounts in the main books of the business or undertaking, that is to say, the books kept in the country where the owners of the concern are domiciled, and not to leave them in the local books. As already mentioned, this will involve their being recorded in terms of the fixed currency, and not retained as balances on the local books in terms of the fluctuating currency.

The reasons for such a course being desirable will be obvious : the provisions for depreciation have been built up year by year by charges in the annual profit and loss accounts or revenue accounts in the fluctuating currency in the local books. As the local currency has a different real value each year, it is clear that the aggregation, over a long series of years, of these annual currency charges would be meaningless. It is necessary to stabilise the annual totals by converting them into terms of the fixed currency.

IV. CURRENCY FLOATING ASSETS AND LIABILITIES

Dealing now with the question of currency floating assets and liabilities, the principle on which these should be converted, for balance sheet purposes, from the fluctuating to the fixed currency, is that of applying the rate of exchange prevailing at the date of the balance sheet.

As will be inferred from what has been stated earlier, the term "currency floating assets" as used in this connection is not intended to include stores purchased in currency, as these do not require to be valued in terms of the fixed currency by applying the rate of exchange prevailing at the date of the balance sheet. They must be valued at the rate in force at the time when they were purchased—in other words, at the equivalent of their *cost*. This principle is, however, subject to the qualification, in regard to goods purchased for re-sale, that they must be written down to their market value at the date of the balance sheet, if such value is less than their cost.

As a rule currency floating assets consist mainly of book debts and of cash balances at bankers and in hand ; and currency liabilities include creditors for supplies and for accrued salaries and wages, and reserves for outstanding expenses payable in the fluctuating currency.

It will be appreciated that if the currency floating assets exceed the currency liabilities then a fall in the value of the fluctuating currency means a decline in the value attributed to the assets less the liabilities ; in other words, there is a loss to be provided for. Conversely, if the currency liabilities exceed the currency floating

assets, then a fall in the value of the fluctuating currency causes a profit to emerge on the books.

Unrealised losses on currency floating assets.

Occasionally the suggestion is put forward that it is unnecessary for a loss on exchange in connection with currency floating assets less liabilities to be computed and provided for until such loss is realised, as will be the case when the currency book debts, &c., have been liquidated, the currency liabilities paid off, and the balance remaining has been remitted and so converted into the fixed currency. In support of this argument it is submitted that the currency floating assets less liabilities represent permanent liquid capital for the local needs of the business ; that when that capital was first provided there was no depreciation in the local currency ; and that although the book debts are in constant process of realisation in cash, and the cash is in constant process of being used to discharge local liabilities, the balance being remitted home, yet other book debts, other cash balances and other liabilities are concurrently being created. " Why not, therefore," say the supporters of this argument, " allow this floating capital which is permanently necessary for the needs of the business, to be valued at the old par rate ? As and when remittances occur, the profits or losses on these will be brought automatically into the accounts. Is not this sufficient, bearing in mind that unless the business is to be closed down the necessary floating capital will never be remitted ? "

This doctrine, according to the canons of good accounting, is unsound. The currency floating assets less liabilities represent circulating and not fixed capital ; and in a balance sheet expressed in terms of a fixed currency, the floating capital cannot be said to be intact if it is included at a figure in excess of its real value on the date of the balance sheet. It is true that the loss owing to the depreciation of the local currency is an unrealised loss at the date of the balance sheet, but the loss is nevertheless a real one, and must be provided for.

Another suggestion which is sometimes encountered concerns a case where at the date of a balance sheet there is shown to be a loss

on the revaluation of the currency floating assets less liabilities, but where subsequent to the date of the balance sheet there was an improvement in the rate of exchange in consequence of which the loss was subsequently made good. It is argued that in such a case there is no need to provide for the loss. It is conceded, of course, that if, under circumstances such as these, the unrealised loss at the date of the balance sheet is provided for, a corresponding profit automatically emerges in the next financial period. It is submitted, however, that there is no logical justification for setting the one off against the other. The loss is in fact a loss attributable to the old accounting period, that is to say, the period to the date of the balance sheet, whereas the profit is a profit properly attributable to the new accounting period, i.e. the period subsequent to the date of the balance sheet.

It will be appreciated that the principle laid down involves as a corollary that if at the date of a balance sheet there is no loss arising on the revaluation of the floating assets less liabilities, but it can be clearly shown that owing to a fall in exchange subsequent to that date the floating assets ultimately realised less than the valuation figure, there is, nevertheless, no need to provide for such loss in preparing the balance sheet. This is admitted: the loss is the loss attributable to the new financial period and not to the old. In an extreme case, however, it may be deemed advisable as a measure of financial prudence, to make some reserve as at the date of the balance sheet, to provide for such a loss. It is, for example, conceivable that in the absence of the creation of such a reserve, the shareholders in a limited liability company might consider that the company's liquid resources permitted of the payment of a dividend at a certain rate out of the profits disclosed by the balance sheet and accounts, whereas owing to the subsequent severe decline in the value of the currency floating capital insufficient resources were available. The fact, however, remains that a balance sheet would be drawn up quite correctly which did not provide for such a loss.

It is of interest to compare the principle on which currency book debts are valued for balance sheet purposes with the principle on which book debts in general are valued, that is to say in regard

to what provision, if any, should be made for ultimate loss on realisation. Let it be assumed, for the sake of illustration, that among the debts owing to an English company at its balance sheet date were the following :

- (a) a debt of £100 from an English customer,
- (b) a debt of 1,150 Argentine paper pesos from an Argentine customer, the sterling equivalent at the date of the balance sheet being £100.

Some four months afterwards, when the English company was completing the preparation of its balance sheet, it is ascertained that owing to the insolvency of the English customer only £80 would be received in respect of the debt of £100 : and that as regards the customer in the Argentine, the debt had been collected in full in paper pesos, but owing to the fall in the Argentine exchange subsequent to the date of the balance sheet, the proceeds when remitted to England only amounted to £80.

As regards the English debt, it would clearly be incorrect to value it for balance sheet purposes at any figure in excess of £80. As regards the Argentine debt, however, it is submitted that the company would be perfectly justified in including it in its balance sheet at £100 although as a matter of fact it had ultimately only realised £80.

The distinction between the two debts may seem a somewhat narrow one, but it nevertheless exists. The decline in the value of the Argentine debt was attributable to circumstances arising entirely subsequent to the date of the balance sheet. Furthermore, a company undertaking business transactions with parties in a country having a fluctuating exchange must experience from day to day, as incidental to that business, losses or profits in exchange, either realised or unrealised, assuming, of course, that the transactions are on a currency basis. The only practical method of dealing with the situation, as between one financial period and another, when preparing accounts, is to revalue the currency floating assets and liabilities by reference to the rate of exchange prevailing at the date of the balance sheet and to deal in the accounts to that date with the profit or loss emerging ; profits or losses

subsequently accruing would then be regarded as belonging to the new financial period. Any attempt to earmark realised profits and losses in the new financial period as appertaining to the floating assets or liabilities existing at the end of the previous period, and to revalue these floating assets and liabilities accordingly, is tantamount to attributing to the old financial period profits or losses which, from an accountancy point of view, really pertain to the new period. The provision for loss on a book debt owing to the default of the debtor is on an entirely different footing. It is the universal practice to make such provision in the light of all the information available at the time when the balance sheet is being completed : the argument that the provision was unnecessary because at the date of the balance sheet itself there was no knowledge of any impending default by the debtor would find no support among accountants.

While a clear discrimination between correct and incorrect accountancy principles incidental to the valuation of currency floating capital has been suggested above, it must not be assumed that in no cases is departure from such principles justified. Not a few public companies fail to maintain consistent principles ; but this forms part of their policy with the express object of erring always on the safe side. For example, if a revaluation of the floating assets and liabilities at a balance sheet date discloses a profit, many public companies will not take such profit to the credit of their profit and loss account at that date as it is not a realised one. If, however, such revaluation discloses a loss they will see that provision for such loss exists in the accounts, either by means of a reserve created in some previous year, or, if no such reserve is available, by making a charge to profit and loss account.

V. STOCKS AND STORES PURCHASED IN FLUCTUATING CURRENCY

There now require to be considered points arising in connection with the treatment of stocks and stores purchased in the fluctuating currency.

As has already been mentioned, it is necessary to adopt such a method of accountancy in regard to these as will enable the actual

or approximate cost of the stocks or stores on hand at any time, expressed in terms of the fixed currency, to be arrived at. This result can only be achieved by converting the purchase price of the stores from fluctuating currency into the fixed currency at or about the time when each purchase is made, at the rate of exchange then prevailing.

In the case of an undertaking such as a railway, or an electric light undertaking, the stores are bought for the purposes of operating, maintaining or improving the undertaking; in other words, they are purchased for use and not for sale. In the case, however, of an undertaking engaged in manufacture or trading, the stores are purchased with a view to re-sale either in the same form as that in which they were bought, or else in a more highly manufactured state. The treatment of stocks or stores falling under either category, so far as exchange is concerned, is, however, identical in principle.

Stores purchased for use.

Referring firstly to stores purchased to be utilised in the operation, maintenance or improvement of an undertaking, such as a railway, these, if purchased for immediate use, may be charged direct to the expenditure account to which they relate; that is to say, they will immediately form part of expenditure on revenue account or expenditure on capital account. But if, as most frequently happens, a stock of stores requires to be maintained, it is necessary to charge the stores, when purchased, to a stores account, and then when a certain quantity of stores requires to be used, to credit the stores account and charge the appropriate expenditure account. It will be appreciated that it is essential to ensure that whenever stores which have been purchased in the fluctuating currency are charged out to an expenditure account, the expenditure account is debited with the original cost of such stores expressed in the fixed currency; and that it is also essential that at any time the cost of the stores in hand, expressed in the fixed currency, should be capable of ready ascertainment. The method adopted to achieve this is to keep the stores account in terms of the fixed currency. It hardly falls within the province of this paper—which deals with general account-

ancy principles rather than with detailed methods of bookkeeping—to describe the means by which this stores account is incorporated in the general bookkeeping system, which system deals, of course, with the fluctuating currency in which the local transactions are taking place.

Stocks purchased for re-sale.

As regards stocks purchased for re-sale at a profit, the nature of the business may be such that the maintenance of a stocks account such as that described above is impracticable. Other means therefore have to be taken to ensure that the stocks in hand at the date of the balance sheet are valued at their approximate cost, represented in terms of the fixed currency. Differing circumstances in various businesses call for different methods of treatment ; but the objective is the same. The scope of this paper does not permit of a description of any of these methods.

In referring to the principle that stocks and stores purchased in a fluctuating currency should be valued, for the purposes of a balance sheet prepared in fixed currency, at their cost, it should be observed that this is on the assumption, as regards stocks bought for re-sale, that there has been no decline in the market value (expressed in sterling) between the time of purchase and the date of the balance sheet. If, for example, a certain stock of material had been bought at the price of 12 Argentine paper pesos per yard at a time when exchange was at the rate of 12 pesos to the £, its cost per yard would be represented by £1. Let it be presumed that at the date of the balance sheet the Argentine peso was at the rate of 14 to the £, and that the market value of that particular class of stock was still 12 Argentine pesos per yard. The market price at the date of the balance sheet, expressed in sterling, would therefore be about 17s. per yard ; and the stock would accordingly require to be written down, for balance sheet purposes, from its cost of £1 per yard to the market value of 17s. per yard.

VI. INVESTMENTS

Before leaving the subject of assets, it is desirable to say a few words in regard to investments in companies domiciled in countries having a fluctuating currency.

In connection with the preparation of the annual accounts of the concern which owns such an investment, the question of the value of the holding may arise, as may also the question of what income can be taken credit for as being derived from the ownership of that investment. In that connection the balance sheet and accounts of the company in which the investment has been made may require to be reviewed. These accounts presumably are expressed in terms of the fluctuating currency, and the question at once arises as to what rate or rates of exchange should be applied to the currency figures appearing therein in order to show their fair equivalent in terms of the stable currency.

For example, let it be assumed that a limited company in England owns the whole of the share capital in a Brazilian company and that the balance sheet of the Brazilian company (which would be expressed in milreis, the currency of that country) may be summarised as follows :—

<i>Balance Sheet</i>					
<i>Milreis</i>			<i>Milreis</i>		
Share capital. . . .	100,000	Debtors	136,000		
Creditors	50,000	Cash	19,000		
Credit balance on profit and loss account	5,000				
	<u>155,000</u>				<u>155,000</u>

Let it be presumed that the English company had acquired the whole of this share capital in the above company at par at a time when the value of the milreis was 6d. And let it be presumed that at the date of the foregoing balance sheet the value of the milreis was 5d.

The investment would first appear in the books of the owning company at cost, namely £2,500—i.e. 100,000 milreis at 6d.

At first sight it might seem as if this investment was fully represented, at the date of the balance sheet quoted above, by tangible assets, because not only are the 100,000 milreis intact, but 5,000 milreis have been added in the form of profits earned and retained in the business. But such is not the case when the balance sheet is

reviewed from the standpoint of sterling, as the 105,000 milreis at 5d. are only equivalent to £2,187 10s. od. Therefore from the point of view of the English company which owns the investment, the shareholding is unrepresented by tangible assets to the extent of £312 10s.

In the case quoted above it has been assumed, for simplicity's sake, that the Brazilian company has no fixed assets. If, however, it happened to own fixed assets as, for example, land and buildings, the rate of exchange at the date of the balance sheet would not, as regards assets of this class, have any significance. The fixed assets would require to be valued by reference to the rate of exchange prevailing at the time when they were acquired or constructed.

VII. OPERATING PROFITS EARNED OR LOSSES SUSTAINED IN A FLUCTUATING CURRENCY

Average rates of exchange to be adopted for conversion purposes.

There now requires to be considered the method by which profits earned (or losses sustained) in a fluctuating currency should be converted into terms of a fixed currency. The general basis, as already mentioned, is that they should be converted at the average rate of exchange prevailing during the period.

In regard to the length of the period in respect of which the daily average rate of exchange should be taken, similar remarks apply as in the case of the conversion of expenditure incurred on capital account, namely that the more evenly the profits are earned, and the less widely the exchange fluctuates, the longer the period that can safely be taken. It may, for instance, be quite justifiable to take a period of as long as a year. If, however, the profits are not earned more or less evenly over the year, and if the fluctuations in the exchange are considerable, shorter periods will probably require to be taken, say, periods of six months or three months, or of one month. In certain kinds of business—and especially in those classes of business where heavy stocks of raw or of semi-manufactured material have to be held—the ascertainment of the profits in terms of the fluctuating currency at so short an interval as each month may involve a considerable amount of additional accountancy work.

If, however, reasonably accurate results can only be obtained by these means, no other course is open. The circumstances of each case must be carefully considered on their merits before a conclusion is reached as to what should be done in this respect. On the one hand there is the natural desire to avoid all unnecessary trouble and expense ; but on the other hand, if proper reliance is to be placed upon the periodical statements of account, these must be accurate enough for all practical purposes.

It may be well to observe here that the figure of profits, arrived at in terms of the fixed currency, as the result of converting at the average rate of exchange profits earned in the fluctuating currency, is not a final figure, but will always need some adjustment.

Leaving out of consideration for the moment accounts of businesses where the conversion of fluctuating currencies arises, it will be appreciated that under a double entry bookkeeping system the correctness of the figure of profits shown by a profit and loss account is in effect proved by the preparation of a balance sheet ; in other words, if profits have been earned they are represented by an accretion in the assets of a business or by a reduction in the liabilities, or partly by one and partly by the other. It is as a rule impossible or impracticable to earmark any particular asset as representing any portion of the profits earned in a period, or to earmark the reduction in any particular liability as being due to the same cause. Floating assets and liabilities are fluctuating in amount from day to day : individually they may increase or decrease quite irrespective of the amount of profits being earned. If, however, there is an increase in the excess of the assets over the liabilities as between two dates (after making allowance for any fresh capital introduced or any moneys drawn out) it can definitely be said, in a normal case, that this is due to profits having been earned during such period.

The foregoing principles may now be considered in relation to a business which is operating in a country whose currency fluctuates, but which is owned by parties in a country with a fixed currency.

Profits and losses to be adjusted by differences in exchange.

Let it be assumed that such a business was operating in the Argentine Republic and that it earned, in a financial year, 100,000

Argentine paper pesos, and that the average daily rate of exchange for that period was 12 Argentine pesos to the £ sterling. The profit and loss account would then show a profit, in terms of sterling, of about £8,333. There are, however, other factors affecting the true profit of the period which will not yet have been taken into account. In practice a number of these factors are usually present in conjunction ; but for the sake of simplicity it may be well to consider an example in which two factors alone exist.

Let it be presumed that in drawing up the balance sheet of the business, the profit of 100,000 Argentine pesos, which has been earned, is represented as follows : 80,000 pesos were remitted to England towards the end of the financial period on a date when the rate of exchange was 14 pesos to the £ ; these therefore realised about £5,714 and formed part of the bank balance in England at the balance sheet date. The balance of 20,000 pesos was represented by a bank balance in the Argentine at the balance sheet date. In common with other floating currency assets it was converted, for purposes of the balance sheet to be prepared in England, at the rate of exchange at the balance sheet date. Such rate was $14\frac{1}{2}$ pesos to the £, and the balance was therefore valued at about £1,380.

Summarising the position, therefore, the 100,000 Argentine pesos, representing the net profit, which had been converted for book-keeping purposes at the average rate of exchange, and were expressed in sterling at £8,333 were, at the balance sheet date, found to have a value of only £7,094 (namely £5,714 plus £1,380). There was therefore a loss on exchange, which arose partly from the fact that the bulk of the profits earned were remitted at a lower rate of exchange than that at which the figure of profits had been converted for bookkeeping purposes, and partly from the fact that the portion of the profits which had not been remitted but had remained in a local currency bank account had declined in value by the balance sheet date.

In the example just considered it had been assumed that the whole of the remittance made was in respect of profits earned during the financial period in question. In practice, however, a remittance made during a particular financial period may be made out of funds

arising from the realisation of currency floating assets in existence at the beginning of the period. If the rate of exchange at which such remittance is made is more favourable than the rate adopted for valuing the currency floating assets at the beginning of the financial period (that is to say, at the date of the previous balance sheet), a profit on exchange would automatically emerge. Such a profit would not, it is true, arise out of the operations of the company on what may be called trading or working account during the period; but it is nevertheless a profit attributable to the period, as it has arisen during the period and is in respect of a floating asset.

Again, a remittance may not be wholly in respect of profits. The remittance may in part be in respect of stocks and stores which, let it be presumed, are purchased in England and dispatched to the Argentine. If the rates of exchange at which the remittances are made are different from the rates prevailing when the stores are dispatched from England to the Argentine, a difference in exchange—either a profit or a loss—emerges in respect of this.

From what has been said above, it will be appreciated that it is generally impracticable—as it is also unnecessary—to ascertain the exact composition of a difference in exchange arising at the end of a financial period on the compilation of a balance sheet. Whatever difference emerges will require to be written off to profit and loss account—except, of course, to the extent to which it may be a difference attributable to capital. This latter matter has already been discussed.

Origin of Difference in Exchange.

While, however, it may be impracticable to endeavour to ascertain the exact composition of a difference in exchange appearing on the drawing up of a balance sheet at the end of a financial period, it is well to consider whether the difference which does emerge is in accordance with general expectations, having regard to the course of exchange throughout the period and other factors. If it does not accord with what might be expected, the matter should be looked into, having regard to the possibility of some bookkeeping error having been committed.

Conversion of Profits at Average of Remittance Rates.

The suggestion is sometimes put forward that instead of the profits being converted at the average rate of the period during which they were earned, they should be converted at the average rate at which actual remittances were made during such period. By this means, it is argued, a smaller difference in exchange will emerge in the accounts. This may very well be the case ; but it does not therefore follow that the accounts are more accurate. In fact, the reverse is probably true. The profits of a business are earned from day to day ; but remittances of such profits to the country having the fixed currency do not usually take place daily, but at longer intervals, partly because very frequent remittances entail corresponding time and trouble, and partly, it may be, with the object of retaining funds temporarily in the fluctuating currency until such time as the exchange rate seems favourable for a remittance. The true operating profits are therefore fairly represented by the conversion of the currency figures, for bookkeeping purposes, at the average of the daily rates prevailing during the period ; and the difference arising in connection with the remittances is not an operating profit or loss but a financial profit or loss on exchange, and as such should be shown separately. Any attempt to merge it with the operating profit, which in effect would be the result of adopting the remittance rates for the conversion of the profits figure, is therefore to be deprecated.

It will now be appropriate to refer to one or two general matters in regard to the treatment of fluctuating currency in accounts which do not fall conveniently into any of the sections into which this paper has so far been divided.

The first of these concerns the question of accuracy.

VIII. DEGREE OF ACCURACY OF ACCOUNTS

While one of the essentials of an accountancy system is accuracy, it must always be remembered that absolute accuracy may not be essential, but that relative accuracy may sufficiently meet all requirements. It will be clear from the description of the bases of

conversions from terms of a fluctuating to terms of a fixed currency, for bookkeeping purposes, that the adoption of an average of the daily rates of exchange for the purpose of converting the gross revenue and expenses of any financial period produces figures which are not accurate in the strictest sense, though they are approximately correct. If the margin of error is obviously very slight, it can certainly be ignored. One obvious method of practically eliminating the margin of error would be to convert the figures relating to the revenue and the expenditure of each day at the rate of exchange prevailing on that day ; but this would clearly entail an enormous amount of additional clerical work the necessity for which it would be difficult to justify.

In reviewing, in individual cases, the probable margin of error and in coming to a decision as to whether its existence is justified, or whether some more accurate (but more elaborate) method of conversion would be desirable, an important point to consider is whether the error is one which is automatically corrected (either in the accounts of the same financial period or in those of a subsequent financial period) or whether it is of such a character that it will be perpetuated.

The above observation calls for some short explanation. In a business where no addition to fixed assets is taking place (in other words, where no expenditure on capital account is being incurred) any profits earned must be represented by an accretion to the floating capital, or else by remittances to the country having the fixed currency, that is to say, the country where the owners of the business are domiciled. If by reason of a somewhat arbitrary basis of converting the figures representing the gross revenue and the expenditure from fluctuating to fixed currency, for bookkeeping purposes, the profit is somewhat understated or somewhat overstated, this profit figure is automatically adjusted, partly by the exchange profit or loss on remittances, and partly by the revaluation of the currency floating assets less liabilities at the date of the balance sheet at the rate of exchange then current. Within limits, therefore, it is immaterial, in such a case, whether the profits are ascertained monthly and converted at the average of the daily rates

for the month, or whether they are ascertained quarterly, half-yearly or yearly and converted respectively at the average daily rates for the quarter, half-year or year. A different profits figure is arrived at in each case ; but in each case a different exchange profit or loss figure emerges ; and when the two figures are taken in conjunction the result is exactly the same in each case.

The fact, however, that the net profit ultimately arrived at is the same is no necessary justification for adopting arbitrary rates of exchange in converting the currency figures of expenditure and gross revenue in the profit and loss account and then showing on the books a large difference in exchange which is thereupon written off to profit and loss. In such a case, the difference in exchange does not wholly represent a real profit or loss on exchange, but would be composed to a considerable extent of differences arising from what may aptly be termed loose accountancy methods. The aim of accountancy as regards a profit and loss account is not merely to disclose the ultimate net profit, but to show as accurately as possible how such profit has been earned. And in that connection it may be very desirable that the account should clearly discriminate between a profit on what may be called trading or operating account and a profit on exchange. The point may, for example, be of special importance where the profits of a business for a series of years have been reviewed incidental to the possible sale of such business, or where profits are being quoted in a prospectus offering the shares or debentures of a limited company for subscription by the public. Or, again, it may be desired to compare figures of expenditure and of revenue, class by class, over a series of years. In this case it is clearly necessary that the conversions of these figures from terms of fluctuating to terms of stable currency should be made, as regards each year, on the most accurate basis which is practicable, as otherwise the comparison may lose much of its value.

If, however, capital expenditure is being incurred in the fluctuating currency, and the method of converting the currency figures representing this expenditure into terms of the fixed currency is too arbitrary and a material inaccuracy results, such inaccuracy, as mentioned earlier in this paper, is perpetuated, as the capital ex-

penditure is permanently embodied in the books either at too high or too low a figure. This means that the profits of the financial period ended on the date of the balance sheet have either been overstated or understated. The same overstatement or understatement of profits exists, of course, if a currency floating asset has been converted, for bookkeeping purposes, at too high or too low a rate of exchange. A currency floating asset, however, is not permanent : it changes in form from time to time and is subject to revaluation or to realisation into the fixed currency. To what extent, therefore, it has been overvalued or undervalued at the end of one financial period (thereby affecting the profits of that period as shown by the books) a corresponding adjustment automatically takes place during or at the end of the next financial period.

IX. REQUIREMENTS OF A SCIENTIFIC ACCOUNTING SYSTEM

The maintenance of a proper system of dealing, in accounts, with a fluctuating currency involves, it must be admitted, certain additional clerical work. Furthermore, the system cannot be wholly free from complications. Neither the additional work nor the complications are, however, so great as might at first sight be imagined.

So far as the additional clerical work is concerned, it will be remembered that in the main the conversions from terms of the fluctuating to terms of the fixed currency deal with totals and not with individual items. And as regards the complications, these are apt to disappear when once the main principles to be borne in mind and the main objects sought to be achieved are thoroughly understood.

In practice one not infrequently experiences cases where those owning or administering a business which is being carried on in a country whose currency fluctuates, allow the records to be dealt with throughout a financial period on a basis which assumes that the currency is a fixed one. Then at the end of the financial period they seek to make the necessary adjustments in preparing the balance sheet, and if insufficient data exists—as is very probable—for the purpose of making proper adjustments, they are content to make approximate adjustments ; and they claim that the accounts will

then be sufficiently accurate for practical purposes. Their avowed object, of course, is the saving of time and expense.

It is hardly possible to emphasise too strongly the inadvisability of such a procedure. The saving of time and expense is a trivial benefit to set against the possibility that the accounts so prepared may be inaccurate to a material extent, bearing in mind that no adequate means are then probably available to prove whether all necessary adjustments have in fact been made.

X. CONCLUDING OBSERVATIONS

Before bringing this paper to a conclusion, the writer wishes to make a few general observations.

In the first place he desires to make it clear that all the points discussed and principles laid down have been dealt with from the standpoint of British accountancy practice and British law.

The second observation is that anyone attempting to prepare a paper upon a somewhat specialised subject is under a peculiar difficulty if he knows that some of his audience have had a wide practical experience of the matters treated, while to others many of the points discussed constitute new ground. To those of the audience who fall under the first category, apologies may be needed on the ground that the subject matter of the paper is unduly elementary. On the other hand, those who belong to the second category may quite conceivably complain, with perfect justification, that too great a knowledge of the subject on their part has been taken for granted and that, as a consequence, they cannot appreciate fully some of the explanations given or arguments used. Of both classes of audience, therefore, the writer has to ask indulgence.

Apart altogether from the advantages which an International Congress of Accountants confers on us as professional men in the interchange of views and ideas on accounting and kindred subjects, there are the wider benefits which we all derive from mixing with each other as citizens of various countries in friendly intercourse. By so doing we may hope to obtain some insight into each other's outlook and mentality, and to appreciate something of the special difficulties and problems with which each nation is confronted.

In spite of the greatly improved means of communication which science has placed at man's disposal in recent years, each nation still lives largely in a watertight compartment, created in part, it is true, by geographical conditions, but due in no small measure to the restrictions imposed by different languages, different laws, different fiscal systems, different currencies. And greater still, by far, are the difficulties which have their origin in unstable forms of government and unsound national finances. It is to be hoped that, in course of years, the ingenuity of man will overcome these man-made barriers, which can only be a hindrance to international intercourse, and therefore to international amity. One such barrier is that represented by a fluctuating currency. But we can, at least, say this—that the more the realisation of the existence of this barrier is brought home to the world, the greater the possibility that in course of time means may be found by which it can be overthrown.

DISCUSSION

THE CHAIRMAN : Ladies and gentlemen, I will now call upon Mr. Cutforth to submit his paper entitled " Exchange Fluctuations in relation to Accounting as regards Operating Results and Asset Values." If the discussions do not come to an end at one o'clock, the time fixed, then we will continue them after lunch, at half-past two.

MR. A. E. CUTFORTH, C.B.E., F.C.A. : The subject which has been allotted to me is one which has assumed special importance of recent years owing to the fact that so many currencies of the world are no longer linked to any common standard, such as the standard of gold. At the same time, it is a very specialised subject, and not one, I fear, which lends itself to any very interesting or attractive method of treatment in the form of an address.

The main principles on which a fluctuating currency should be dealt with in accounts may be said to be accepted universally. It is rather in the method of their application to individual circumstances or individual transactions or classes of transactions that there may be divergencies of view.

When we speak of a fluctuating currency, the question at once arises : " Fluctuating as compared with what ? " The answer which at once springs to one's mind is : " Fluctuating as compared with gold." But it is not in that sense that the term " fluctuating currency " is used in the paper which I have prepared. When we speak of the treatment of fluctuating currency in accounts we usually have in mind the fact that the accounts are concerned with two currencies (and possibly more) which fluctuate in comparison with each other. Neither of these currencies need be linked to gold. In a case where two such currencies are involved, which is to be looked at as the one which fluctuates, and which is to be regarded as the one which remains steady ? The answer, as I suggest in my paper, is that the currency to be deemed to be the stable or fixed one is the currency of the country in which the owners of the business or undertaking reside—or, what probably amounts to the same thing, the country where the head office of the business is situated. An Argentine citizen having a business in Buenos Aires with a branch in London

would treat the Argentine currency as fixed and the English currency as the fluctuating one. His balance sheet and profit and loss account would be prepared normally in terms of the Argentine peso, and for this purpose he would convert transactions occurring in sterling in connection with the English branch into pesos for bookkeeping purposes at the appropriate rates. On the other hand, an Englishman owning a business in London and having a branch in the Argentine would treat sterling as being the fixed currency and the Argentine currency as being the fluctuating one. His annual accounts would, of course, be prepared in terms of sterling.

Having commented briefly in my paper on the foregoing assumptions, I deal with the question of the conversion of fluctuating currency figures into terms of stable currency for bookkeeping purposes under four main heads :—

- (1) Expenditure on capital account, represented as a rule by what are called “fixed assets.”
- (2) Floating assets and liabilities, such as debtors, cash, creditors.
- (3) Materials in hand, represented by what are usually known as stocks or stores.
- (4) Investments.
- (5) Expenditure and revenue on what may be called “profit and loss” account.

As I have already indicated, the broad principles on which these classes of figures should be dealt with for purposes of converting them from terms of fluctuating to terms of a stable currency are universally accepted; but on applying these principles, problems arise of which the right and proper solution may be the subject of argument. Therefore, after enunciating in each case the broad principles, I have reviewed certain matters in connection with their application which arise in actual practice, on some of which more than one view may fairly be held. Time does not permit me, in these opening remarks, to deal with each of these points. I may perhaps, however, mention some of them by name.

In connection with capital expenditure, there is the question of exchange profits or losses in connection with liabilities incurred or floating assets temporarily accumulated incidental to such expenditure.

In connection with floating assets and liabilities in fluctuating currency, there is the question of the treatment of an unrealised loss on exchange or an unrealised profit, as shown by a revaluation of those assets and liabilities at a balance sheet date.

In connection with operating profits earned or operating losses sustained

in the fluctuating currency, there is the question of the frequency with which the figures should be converted for bookkeeping purposes into terms of the stable currency.

Having discussed certain points arising under one or other of the five heads to which I have alluded, my paper deals with certain matters of a general character. One of these concerns the question of accuracy. Admittedly, no system of dealing with transactions taking place in fluctuating currency in the bulk yields results which are absolutely accurate. Under a proper system, however, the results should be accurate enough for all practical purposes ; and in connection with the question of the possible margin of error, I discriminate between cases where the error, whatever it is, is ultimately adjusted on the preparation of a subsequent balance sheet, and cases where the error remains permanently in the accounts. Clearly a larger margin of possible error under the first category can be defended than under the second category.

The next matter of general interest to which my paper refers is that of the additional clerical work which a scientific system of dealing with fluctuating currency entails. I suggest that when once the system has been properly grasped and the accountancy staff have accustomed themselves to it, the additional work is relatively small, as in the main the conversions from terms of fluctuating to terms of stable currency deal with totals of a number of transactions and not with transactions individually. And I go on to submit that whatever the extra work—and therefore extra expense—may be, it is well worth while in the interests of safety and accuracy.

I conclude my paper by deploring the fact that in an age when science has done so much to facilitate communication between the nations of the world there should still be so many man-made barriers which tend to keep them apart. Of these man-made barriers, fluctuating exchange is but one. Is it too much to hope that by man's ingenuity this barrier may, in course of time, be overthrown ? That day may come soon or it may come late. But its coming may well be hastened if the citizens of the various countries seize every opportunity which comes their way to meet in friendly intercourse, to enjoy each other's hospitality, and to endeavour to obtain some insight into each other's peculiar problems and difficulties ; and that is not the least of the parts which this International Congress of Accountants hopes to play.

MONS. N. BUTCULESCU (translation) : One of our problems, and a very important one, is that of inventory valuation. Sir Woodburn Kirby,

F.C.A., London, remarked very justly in the paper he read before the New York Congress (1929) that this problem has always been before our colleagues from the very earliest days of accountancy up to the present time. Inventory valuation is such that it can alter the results of the balance sheet and profit and loss account. This is what the accountant tries to make clear, by taking as a working basis what he considers to be a true estimate of the circumstances in which the balance sheet has been struck.

Let me here remark, as Lord Plender mentioned in one of his articles,* that, in questions of finance and accountancy the word "profit" is not capable of exact definition. After the Great War the instability of currencies provided a new aspect of the problem of valuation for accountants, although the problem was already complicated enough. The results of currency instability were felt with greater intensity in those countries where money depreciated most. This was the case in Germany, where the first experiments and attempts were made to enable accountants to fulfil their function, namely, that of presenting a business in its true light and of showing results comparable with previous ones and with those of similar businesses, not only in normal times, but even during periods of marked currency fluctuation.

This problem is still to the fore, though less urgently, in England and the United States of America. We have it also in Roumania.

During the years directly following the Great War, accountants disregarded these fluctuations and adopted paper money as a basis for their records. Generally speaking, their balance sheets showed extraordinary profits, which gave the illusion of prosperity and enabled large dividends and bonuses to be distributed, whilst also enabling the Treasury to collect large sums in taxes, that were much appreciated by the organs of the Ministry of Finance.

However, the amortisations, being inadequate, prevented the keeping of materials up to standard; nor were cost prices accurately calculated.

People such as Professor Prion and others, whose acquaintance with the science and technique of accountancy entitled them to speak with authority, drew attention as early as 1919 to the disastrous consequences of these deceptive balance sheets; but accountants and heads of business concerns did not, or would not, realise these consequences in time to apply the principles of correct accountancy to businesses and their results.

* Depreciation and Obsolescence from the viewpoint of the Investor in Securities. By Sir William Plender, Bt., G.B.E., LL.D., F.C.A., London, 1929, page 3.

The role of accountancy and of professional accountants is particularly obvious during a time of crisis ; just as the role of the doctor is most evident during an epidemic. Without being boastful, we may say that as practical and theoretical accountants we have saved many an enterprise and set it on the high road to *real* success.

At a time of exchange fluctuation, it is necessary to take the gold standard as our basis, just as old-time navigators took their direction from the Polar Star. The gold standard may have its defects, but until we find another reliable compass, which would be an *ideal* standard, gold will remain in the near future and probably for many a day the best unit of measure for prices.

At the moment everyone is trying to find an ideal monetary standard, both in America and in the old world.

Although we cannot analyse and mention here all the accountancy methods which have been put forward and tried in the effort to counteract errors of valuation during currency fluctuations, we can, however, mention the following :—

(a) The creation of additional reserves, either open or secret, by under-valuing assets.

(b) Extraordinary amortisations, obtained either by adopting a higher quoted rate of exchange, or by estimating them at the figure of stocks and stores revalued at the current price. This practice was found useful in Germany where, since 1920, the following has been inserted under Article 59 of the Law on Income Tax (“Einkommensteuergesetz”) : “When the balance sheet is drawn up, taxable profits shall include a sum for reserves corresponding to any additional expenditure required to be incurred in the replacement of stocks and stores.”

A similar provision in Austrian legislature recognises the right to provide for extraordinary depreciation, which had to be entered to an account called “Renewal of Plant Account” (Anlage Erneuerungskonto) (see Prof. D. Doerfel, *Die Goldbilanz in Oesterreich*, Vienna, 1925, p. 271). Amounts entered to this account were exempt from tax, on condition that they were used during a certain period for fresh purchases of plant.

In Roumania the law of March 1926 authorised industrial concerns to provide for depreciation up to the amount expended on plant either before the Great War or immediately afterwards, by multiplying this sum by three, four or five, according to the period when the plant was purchased. Amortisations thus carried out were exempt from tax on

condition that they were really used to purchase fresh plant before the 31st December 1931.

Thus we find that the great principle of the *replacement of materials* has been sanctioned by law. This principle was upheld by Mr. I. R. Nash, the Boston economist, in the paper he read before the International Congress on Accounting in New York (Sept. 1929) and also by others.

(c) A final method is to convert the business into a limited company and to increase the capital by (writing up) the assets. This operation makes it possible to provide for depreciation up to an amount equal to the value of the assets in depreciated currency. The awkward side of this procedure is that the Treasury must then be convinced that no tax should be levied on the difference between the initial value and value in the depreciated currency, for the very good reason that no alteration has taken place in the intrinsic value of the holding. Roumanian accountants have found it very difficult to carry this point.

Professor Pietro Bottini, of Milan, in his paper on the "Principles of Drawing up the Balance Sheet" says that it is sometimes necessary to make a complete re-valuation "de novo" on a stabilised money basis of all the items on the balance sheet, in order that the valuation may be correct at the date—or rather, the period—when the balance is closed, taking into account the state of use of the items on the inventory.

Mr. Maurice Peloubet, C.P.A., New York, also emphasises the *permanent nature of the inventory*, which must be considered when making valuations.

Finally, Mr. J. M. Clark, in his paper on "Valuation for the Balance Sheet and Profits," read to the Congress in Amsterdam (1926), introduces a new idea, when he says: The theory of valuation, in connection with the reproduction of equipment, should be applied on the principle of "what it would cost to reproduce, not the identical equipment, but an equivalent service value in up-to-date machinery," which may be dearer, or perhaps cheaper, than the old equipment.

All these methods of counteracting the effects of currency depreciation—a phenomenon which has significant results for all of us—are merely palliatives.

MM. Raffegout and Lacont in their "Etablissement du Bilan or" Paris, 1926 (page 65) justly observe that these methods, obtained from insufficient data and governed by no rules, cannot eliminate the results of monetary depreciation.

In this connection, our Roumanian colleague, Dr. V. M. Joachim,

Managing Director of the Corpului Contabililor Experti si Autorizati in Roumania, in his study on the "Balance Sheets and Currency Fluctuation" (page 60) points out that isolated methods, used to counteract the results of the balance sheet at times of monetary fluctuation, cannot solve the problem of the balance sheet as a whole, for they only affect certain items on the balance sheet and are not based on any fixed and uniform standards; they are at the mercy of the head of the business, and depend on the position of the business.

It would appear that the real solution for the problem of recording values and showing real profits and losses at times of exchange fluctuations would be to adopt a fixed standard, at any rate for domestic accountancy. This gave rise to the idea of accounting and setting up the balance sheet in double columns, proposed by M. E. Delavella, Paris (1922), one column being for the gold value and another for the value in paper money; this solution would also have the advantage of meeting the requirements of the law, supposing the latter were only to recognise balance sheets and records expressed in national money.

One might mention many other methods proposed in literature on accountancy, to counteract the effects of monetary depreciation in balance sheets. As regards Mr. Cutforth's paper covering this subject he did not emphasise that we have to hold tight to the gold standard.

I have merely presented this important problem in a general way. In conclusion I wish to quote the statement of Mr. J. M. Clark, of the University of Chicago, who said: "Accountancy cannot take the place of management," and that the accountant has the task of "determining what the earnings of the concern have been, in order that the management may know how much they are free to divide to the owners without trenching on capital." With regard to inventory valuations, the words spoken by our English colleague, Sir Woodburn Kirby, at the New York Congress in 1929 are conclusive, when he gave as his opinion that during monetary fluctuations we should make our valuations on the gold standard basis, and if we have no law to guide us, as professional accountants we should attack the problem in a spirit of confidence and security.

We thoroughly approve of these principles and would suggest that they should always be taken into consideration, thus avoiding confusion and inaccuracy in balance sheets.

MR. B. G. LONGSTAFF, A.L.A.A. (Great Britain): Mr. Chairman, ladies and gentlemen, the subject matter of this paper has been dealt with in such an exhaustive manner by Mr. Cutforth that it is not possible

for any of us to enlarge upon it, having regard to the short time at our disposal. I have only one small comment to make and that is this. In connection with the charge for depreciation of fixed assets situated in a country which we in England would call foreign, we all know that at the time when those fixed assets were acquired, the principle upon which to convert the purchase price of those assets should be the rate prevailing at the time of purchase. At first sight, in order to arrive at the annual charge for depreciation, it would appear to be necessary only to calculate the life of an asset and divide the purchase price by the number of years. With currencies fluctuating as they are, from day to day, from month to month and from year to year, it is necessary to make that annual charge for depreciation conform with the fluctuations in the exchange. That is just one point that occurs to me that needs emphasis in Mr. Cutforth's paper.

MR. WALTER HOLMAN, F.S.A.A. (Great Britain): Mr. Chairman, my Lord, ladies and gentlemen, your presence in the chair this morning, Mons. Van Dien, reminds me vividly of the Second International Congress at Amsterdam in 1926. As one of the delegates to that Congress, I should like, if I may, to digress for a moment in order to say, on behalf of those of us who were delegates to that Congress and who appreciated and enjoyed your generous and delightful hospitality on that occasion, how delighted we are that our Dutch colleagues and you as their Chairman are here in London and that we are able to make some return for your kindness on that occasion. (Applause.) It is particularly appropriate that this paper on fluctuating exchanges should come immediately after the paper on International Finance to which we have listened this morning because this paper represents practical accountancy applications to those difficulties which were dealt with in the paper and which the subsequent discussion did so much to elucidate.

In the closing observations of this paper, the writer refers to the difficulty of dealing with a technical subject in such a way that it will prove acceptable and intelligible both to those who have practical experience of the subject and to those who have little or no experience. Under whichever category we come—and modesty forbids us to classify ourselves—I think we will all be agreed that Mr. Cutforth has overcome his difficulty with complete success, for he has made a difficult subject appear to be simple and he has given us a paper which, for clarity of expression and thoroughness of detail, will, I think, hold a high place in the records of this Congress. (Applause.) The writer of the paper has laid down

principles and has indicated their application so completely in accordance with accountancy practice that he would be a brave man or a foolhardy man who would attempt to dispute them. But I think Mr. Cutforth would be the first to agree the difficulty which must arise in applying those principles in practice and the necessity for dealing with each case on its merits and using discrimination in the application of the principles. Let me give one illustration of what I mean. There must always, even in the most efficient accountancy system, be a period between the date of the balance sheet and the date at which the balance sheet is prepared and, in these days particularly, great differences in valuations may occur in that period owing to the fluctuations of exchanges. Mr. Cutforth has laid it down as a principle that the date of the balance sheet is the date at which the values should be fixed and he has said that any profits or losses which become apparent between the two dates are properly profits or losses relating to the subsequent period. I am going to submit to him that while it would be unwise to fail to make provision for a loss on exchange merely because there has been a subsequent rise, and while it would be still more unwise to anticipate a profit from that cause it would be sound business and sound accountancy to make provision for a loss at the time of the balance sheet, either by way of a direct allocation of available profits or by a note in the balance sheet.

The value of Mr. Cutforth's paper has been enhanced by the illustrations he has given, but most of those illustrations are given in terms of fluctuating currencies which disagree in name with the fixed currency. I want to emphasise the fact that the necessity for the provisions and the rules which he has laid down is equally great where the fixed currency and the fluctuating currency are similarly named. The Australian pound—to take only one example—has for some time past been at a discount of between 20 and 30 per cent. in relation to the English pound, and the profits and losses represented by that difference in value should be provided for. That is obvious, but the effect of the similarity of nomenclature is such that the necessity for making provision is not so obvious and indeed may be overlooked.

In the section of his paper dealing with currency floating assets, Mr. Cutforth draws a distinction between stores purchased in the fluctuating currency and other floating assets similarly purchased. I confess that I cannot quite follow his reasoning for drawing that distinction. He admits that goods which are purchased for re-sale must be re-valued at market price at the date of the balance sheet. If I am right in inter-

preting his use of the word "stores" as representing goods which are purchased for use in manufacture, then I can see no difference between such stores and stock-in-trade. Any loss in value represents a loss of revenue which should be provided for. The proceedings at the World Economic Conference do not encourage the hope that there will be, in the near future, at any rate, any appreciable lightening of the burden of fluctuating exchanges, and accountants generally will be glad to have, in Mr. Cutforth's paper, a sound and safe guide in the difficulties which are inherent in the present conditions. Therefore, in expressing my own thanks to Mr. Cutforth, I am sure that I am expressing also the views of all the accountants who are present and represented at this Congress.

MONS. J. C. A. VAN DER SPIL (Holland) : Mr. President, my Lord, ladies and gentlemen, I am thankful for the opportunity given me to make a few remarks, and more especially as I do not entirely share Mr. Cutforth's opinion.

In the first place I want to point out that I differ from his opinion where it is said, on page 70, under II, "that capital expenditure incurred in fluctuating currency should be converted into the fixed currency at the rate of exchange prevailing when the expenditure was incurred." In the case of very small differences we may do so, but in the case of large ones we only can follow the given rule in those hardly impossible circumstances whereby against the depreciation of a certain currency we find an equivalent in an equal increase of prices in the country where the currency has depreciated. In my opinion this will be in general a theoretical supposition ; the practice will be that when a currency is depreciated the possibilities of making profits from the standpoint of the foreign owner who calculates in gold will be decreased ; especially will this be the case when the Government seems to be able to maintain the level of the prices at the same basis as the currency was when the expenditure was incurred. This is the case here in this country, where we saw the English currency going off the gold standard, which was fortunately not followed by an increase in prices. It may be possible that this is to a certain extent as far as raw materials are concerned on account of a decrease of their prices. But when their quotation will go up it is not likely that the costs of the labour also will follow to the same extent the devaluation of the English currency, which will reduce the purchasing power calculated in gold. It follows that under these circumstances the possibilities of making profits calculated in gold will be less, and, moreover, we have to reckon with the facts, that the costs of capital expenditure in future, calculated

in gold, will also have been reduced. To make the position clear : Take, for instance, a Dutch company that owns real estate, for instance a large office building in London with English tenants. The costs were, say, £200,000 before England went off the gold standard, which means, converted into Dutch currency, fl. 2,400,000, at which amount it appears in the books of the company. When drawing up the balance sheet after the devaluation of the English currency to the principles of Mr. Cutforth the Dutch company has to take up the real estate with the amount of fl. 2,400,000. This means, however, that the equivalent in English currency will be in fact, calculating 8 fl. to the £, £300,000. I think it will be advisable to review the value of the real estate in the accounts of the Dutch company. To avoid misunderstanding, I do not say that the treatment will be the same as we convert the floating assets. I only want to point out that we may not maintain conversion as advocated by Mr. Cutforth. Another important problem will arise when the home currency is depreciating in a way such as we have experienced during 1921-23, by the inflation in Germany and the depreciation of the German mark. In this case the German merchant would have got absolutely wrong figures of the results by the theory that in regard to the home currency one need not worry, as I understand it from page 69. I only raise the point ; I shall not try to work it out. I leave that to the ladies and gentlemen. Our German colleagues have done it already. I will just remind you that the German merchants often kept their accounts in the period 1921-23 not in their own but in foreign currency, especially English or American. No doubt, Mr. President, we realise that the fluctuations in exchange which occur cause great difficulties, and we may be grateful to Mr. Cutforth for giving consideration to such a difficult thing. Let us hope that the main currencies will be stabilised in the near future. In that way the £ sterling will regain its brilliant position in the world.

MR. C. H. WELLS, F.S.A.A. (Great Britain) : Mr. Chairman, ladies and gentlemen, it is difficult in this admirable paper to find subject matter for discussion. The features of the subject have been covered in a complete and masterly manner, and the conclusions reached are so obviously correct that few will be found with sufficient skill to criticise or temerity to question those conclusions.

Those of us who took part, on one side or the other, in the Great War, which so profoundly altered the international financial situation, can at any rate take comfort in the fact that we have survived to consider the problems which have been created, and one day we hope to see their

solution, however long postponed by the failure of international financial conferences to agree upon a basis.

With regard to currency depreciation after the date of the accounts (page 82) it is submitted that the principle of reserving in the form of a suspense account, which may be amended in future periods, a margin to cover possible losses owing to fluctuating currency, is a sound one. It may prevent a dividend being paid out of profits which may have disappeared, and it may also provide additional information to an individual shareholder, assisting him to form his own conclusion as to the true position, a state of affairs which the Courts of England have frequently pronounced to be the only desirable form in which accounts should be presented.

Again, though it is not usual to take credit for a profit disclosed on a revaluation of floating assets and liabilities (page 84) yet it should not be overlooked that such a state involves a hidden reserve, on the propriety of which much difference of opinion exists, and which may afterwards be drawn upon, with results which are sometimes deprecated.

Forward purchases of currency. Apart from the accounts of companies with holdings abroad, few accountants are without experience of dealing with remittances in foreign currency at a future date to meet obligations incurred there. It is a frequent practice, indeed a prudent course, to buy currency through an exchange broker at a forward date, thus making the results of the transaction certain, apart from the question of profit, and eliminating the element of gambling consequent upon exchange fluctuations. The risk would thus appear to be transferred to the broker except for the fact that he has probably a number of transactions per contra in the same currency at similar dates, so that if his business or turnover is sufficiently extensive, he is able to supply or receive approximately equal consignments of currency at the same rate, covering himself against loss, the commission charged to all parties representing his certain profit.

If these forward currency transactions are confined to traders in one country only, they amount in the aggregate merely to mutual insurance against any loss, or profit, being made on fluctuations of exchange, but if the transactions are complicated by dealings with many nationals, including those in the country whose currency is being dealt in, it is difficult to decide who is eventually affected, and to what extent. The author may perhaps feel inclined to discuss this.

I join with other speakers in thanking him for his services to the

profession in preparing this contribution to a subject which is seldom explored.

MONS. ING. J. FUKÁTKO (Czechoslovakia): Mr. Chairman, my Lord President, ladies and gentlemen, before entering into discussion of Mr. Cutforth's paper allow me to greet the Congress in the name of Czechoslovakia. I am bringing the heartiest greetings and best wishes of a full success of the Congress from a country that is situated in the geographical heart of Continental Europe and on behalf of three bodies of expert auditors in Czechoslovakia and on behalf of the College of Business Administration in Prague, which I have the honour of representing. I do so with particular pleasure for I can offer my greetings in the capital of a country to which my nation is very indebted for its unselfish and generous aid in its struggle for independence during the Great War.

We also extend our sincere thanks to the sponsors and organisers of the present Congress, who shrank from no sacrifices in order to enable us to carry on the international co-operation that had been so promisingly initiated at the preceding Congresses. I feel sure that the successful course of the present Congress will at least partly repay the sponsors for their untiring efforts which they have displayed for the success of the Congress.

Now will you allow me to make a few remarks on Mr. Cutforth's paper? (Mr. Fukátko continued his remarks in French). (Translation).

In his excellent paper, Mr. Cutforth has given us an outline of the principal problems which present themselves in practical accountancy following the variations in foreign currency. Mr. Cutforth bases his deductions on the fact that the currency of the country is considered as stable, at least as far as the accountancy point of view is concerned.

In taking part in to-day's discussion I also base myself on the accountancy point of view, but I am going to develop my observations from the point of view of the fluctuation of the currency of the country. My considerations involve the influence of this fluctuation on the book-keeping and the balance sheet. These considerations emphasise the importance of the theses dedicated to this subject at the previous Congress in New York; they are based on the experience acquired in this connection in Czechoslovakia.

Up to the year 1918 our country was part of the Austro-Hungarian Monarchy. But the currency that we have inherited from that powerful formation, now dismembered, is very much devaluated by inflation. This devaluation was about tenfold by comparison with before the war,

when currency was based on the price of gold. Our State decided as its first duty to arrest the devaluation of the monetary unit and to stabilise the rate on the basis of the price of gold.

Our financial policy was crowned with success, as since 1921 we have succeeded in completely stabilising our monetary unit—the Czech Crown—in relation to the gold standard. In this connection we are one of the few States whose after-war currency has suffered no variation, however small, in its relation to gold. In spite of this circumstance we have been obliged to solve the problem caused by the fluctuation of the money of the country, for the reason that a great number of undertakings which were created prior to 1921 had compiled their balance sheets with dissimilar values, side by side with values expressed in the balance sheet by the nominal value of gold crowns before the war, and war crowns partly devalued; there also existed values of later origin whose increase in the balance sheet was already shown by the devalued and stabilised units of currency. To the first category belonged primarily the immobilisations and to the second the disposable values, also the immobilisations made by the undertakings after the war. But the result of this state of affairs was that the balance sheets did not give an exact view of the worth of the undertakings and even the profit and loss accounts gave very modified results. This inequality of balance sheets was shown above all in the amortisements of immobilisations, because the amortisements made on the value of the assets immobilised before the war were far from equaling the cost of the productive replacement of relative immobilisations, without considering even the account of revenue in profit and loss as the basis for the calculation of profits, as regards their distribution, or of the net cost price not being satisfactory for the changed situation.

It was only in 1927 that this state of things was efficiently remedied, and that by a special law allowing undertakings with dissimilar balance sheets to proceed to their readoption and stabilisation.

The principal stipulations of the law of stabilisation of balance sheets are the following: Undertakings which have on their balance sheets immobilisations of which the continuity of the balance sheet was interrupted by the monetary variation could, before the end of 1931 at the latest, proceed to their revaluation according to the current rate, taking account of any existent deterioration, passing them accordingly in their balance sheets.

Any surplus of capital resulting from this revaluation should not be used for distribution in the form of dividends but should be assigned as

special capital, or in augmentation of capital. Likewise, if a deficit results from the revaluation this should be compensated for from the reserve fund or deducted from capital.

By the stipulations of the law indicated it has been possible to provide for passing the re-valuation of immobilisations in the stabilised balance sheet in similar values. The profit and loss account was in the first place adapted to the changed situation in the amortisements of immobilisations.

I suppose that to-day, at a time when we are witnessing a considerable de-valuation in comparison with the gold standard in the principal States, the question of stabilisation is again the rule of the monetary policies of States, the problem of the relation of the balance sheet to the new valuation of immobilisations becomes apparent, and this is why I think my observations on the facts and experiences in our country will not be without interest to other accountants.

THE CHAIRMAN : Ladies and gentlemen, the speech of Mons. Fukátko will be translated into English in the Congress Book. For your information, I want to say that Mr. Fukátko has told us that, in Czechoslovakia, they had the same trouble as you had in England by reason of the rate of exchange, but in 1927 they made a law to remedy those difficulties. One of the principal articles of that law is that any profits that arise from a rearrangement must not be used for dividend ; they must be put to reserve or written off.

(Adjourned until 2.30 p.m.)

(The Session was continued at 2.30 p.m.)

THE SECRETARY : Ladies and gentlemen, I have received this telegram this morning : " Wish the Congress every success in its course in the interest of the profession. Verband Deutscher Bücherrevisoren Wirtschaftsprüfer und Treuhänder, Berlin."

DEAN J. C. MYER, C.P.A. (United States of America) : Mr. Chairman, ladies and gentlemen, I should like to express the appreciation of the American Society of Certified Public Accountants and the New Jersey State Society to Mr. Cutforth for his excellent treatment of a difficult subject and his brilliant exposition of exchange fluctuations. I am sure that his paper will have even a more far-reaching effect than upon our individual practice ; it will find its way into the teaching of accountants. I am a schoolman of the States along with Professor Himmelblau of the North Western University and Professor Hatfield of California, who are attending this convention. We know that the literature on exchange is

not up-to-date and Mr. Cutforth's paper will serve a useful purpose in that connection. I have just one regret. I think that the scope of his topic was not broad enough to permit him to give his reaction to, and his solution of, the present ills in foreign exchange. That affords me the opportunity to make a recommendation that I have wanted to make for a number of years, that accountants all over the world should take more interest in public affairs and particularly in those intercourses which affect foreign exchanges between countries. I should like to recommend that when the next Economic Conference is convened, if that should happen, that in the delegation from each country there should be at least one Authorised or Chartered or Certified Public Accountant, not merely as an adviser to the Commission but as a delegate, one who can speak with authority. As I sat on the platform this morning and saw the community of interest in this audience, I was impressed with the fact that all of us, no matter from what country we come, no matter what are our conditions, understand each other's practices and, I might say, language, and I am sure that if Certified, Chartered or Authorised Accountants take more interest in and become members of Tariff Commissions, Economic Commissions, or any of those bodies that are helping to solve our international problems, we may find the solution just a little faster than in the present situation that is going on. That gives me the opportunity also to recommend that all of us, particularly those of us in the States, should take more interest in public affairs. Of course, we have difficulties in arriving at such a conclusion. For a number of years accountants have been reticent, they have been too conservative to mix with their fellows in any public activities, but I believe that the training, the conservatism, the stability and the practical experience of accountants are necessary in just such a situation as Mr. Cutforth has explained, to eradicate the ills of these widely fluctuating exchanges.

MR. J. G. BHANDARI (Indian Finance Department, Accountant-General of Posts and Telegraphs, India) : Mr. Chairman, ladies and gentlemen, Mr. Cutforth has dealt exhaustively and very ably in his paper with the question of exchange fluctuations in relation to accounting. I venture to draw your attention to another aspect of the problem, the question of exchange fluctuation in relation to Government accounts. I come from India and am connected with Government accounts. I happen to be an accountant in the Department of Posts and Telegraphs. The accounts of the Government of India are kept in rupees, while a certain portion of the expenditure is incurred in England. Without going into the genesis

of the present system, I will just tell you how the expenditure incurred in England is shown in the Government of India accounts. That expenditure, sub-divided under the appropriate heads of classification, is converted into rupees at a certain arbitrary rate—it may be one-sixth—and is shown in the Indian accounts under the corresponding heads, while the difference between this arbitrary rate and the real rate of exchange is shown under the head “gain” or “loss” on the exchange. Under normal conditions, this system is sufficient for practical purposes and perhaps fulfils the test prescribed by Mr. Cutforth, but under certain conditions—for instance when, during the war period, the exchange went up to 2s.—the figures as shown in the accounts, according to this method, did not really give a correct idea of the true state of affairs. A large portion of the actual expenditure under the various heads was shown under what is known as “loss or gain on exchange.” Then, again, there is this problem. If the actual rate of exchange differs and there is a great divergence between the real and the arbitrary rate, there will be another difficulty. In Government accounts it is essential that, for the purposes of comparison, we should have the same standard. One likes to compare the expenditure of 50 years ago with that of to-day, but if one takes the rate of exchange to be one-sixth at one time and two at another time, for the purpose of comparison, the figures are misleading. I thought it right to bring this point to your notice. It would be interesting if Mr. Cutforth or some other speaker would throw some light on the method by which this problem of Government accounts is dealt with in other countries.

MR. WILLIAM CASH, F.C.A. (Great Britain): Mr. Chairman, ladies and gentlemen, at this late hour when we are close on the time for the next paper, one almost hesitates to intervene at all, but I should like to have the opportunity of saying just one or two words on Mr. Cutforth's paper; in the first place to congratulate him upon both its structure and its matter. I venture to suggest that, after taking us through the logical reasons which lead up to the practice, he has in this paper set out what I may describe in this country as the best accountancy practice dealing with accounts of undertakings carrying on business abroad. The difficulties that arise to-day, as he points out, are, of course, very great, in two particulars. First, as regards the fluctuations in exchange which take place so continuously and, secondly, the difficulty which arises in regard to what I might term floating credits and floating balances abroad. But when you consider that the object to be attained in setting forth the accounts of an undertaking carrying on business abroad is to represent

the true position here in the currency of the owning undertaking, that I think, is the real line which defines the method followed in accountancy practice.

There is only one other point to which I would like to allude in passing. Mr. Cutforth suggests, perhaps with a little diffidence, that the most useful way of stating the earnings over any financial period is to take the average rate ruling over a period for the purpose of converting that profit into home currency. I venture to think—and I speak with some experience of practice both of auditing and administration of companies carrying on business abroad—that that is really the most satisfactory way of dealing with it. There is one additional reason for saying that, and that is that if, as frequently happens, there is necessity for reviewing the charges or the earning capacity of that particular undertaking, in relation to the capital employed therein, there is no doubt you get a much more accurate result of such transactions or the profits earned during any financial period by taking the average rate ruling over that period. Then, as Mr. Cutforth points out—and I think he makes it abundantly clear—so far as the accuracy of the balance sheet is concerned, when you come to it later, any inaccuracy in the profit and loss account is corrected in the balance sheet by writing down the floating assets, or writing them up, as the case may be, at the rate ruling at the date of the balance sheet. In that respect, I entirely agree with Mr. Cutforth's views.

Thank you, sir, for giving me the opportunity of saying a word. I should like to congratulate Mr. Cutforth on his paper.

THE CHAIRMAN : Mr. Cutforth is going to make some remarks in reply to the discussion on his paper.

MR. CUTFORTH : Mr. Chairman, ladies and gentlemen, I will be as brief as I can in my replies, as the time is very short. I hope, therefore, that any of the speakers who do not find their queries answered by me will excuse me because of this limit of time. Mr. Butculescu, in his remarks following mine, dealt with this subject from a somewhat different angle from that with which I dealt with it in my paper. I was considering the case where the balance sheet and the profit and loss account had to be presented to the owners of a business in the currency of the country where the owners resided, but where the business itself, in whole or in part, was being carried on in another country. Mr. Butculescu deals with a case where one currency only is bought and that is where the business is wholly carried on in one country, but where the currency of that country has fluctuated very widely. He suggests that, in such a case, it may be

necessary to take the gold standard as a basis, or, alternatively, to show the accounts in parallel columns, with the paper money in one column and the gold equivalent in another.

One appreciates that there is a great deal to be said in favour of Mr. Butculescu's suggestion, particularly in countries where the currency has fluctuated very widely, but there are possible objections to such a procedure. One objection is that to people in such a country, figures expressed in gold have little or no meaning. They are not conversant with them, they do not understand them. Therefore, it is a question whether, if you turn one of those currency balance sheets into gold, it will be any more intelligible than it was before to the people who have to read it.

There is another difficulty and that is this, that gold itself has by no means a fixed value when you compare it with commodity prices. We can take an illustration from our own country, England. In the spring of 1931 we were on the gold standard and our £ was in effect a gold coin, Now we are off the gold standard and in comparison with the gold £ our £ is only worth about 14s.; but owing to various causes, including the world-wide fall in commodity values, many things can be purchased cheaper to-day in our currency than they could be purchased in the spring of 1931 with the gold £. So you see that if we in England, for example, attempted to-day to make a gold equivalent to our currency and to express our balance sheets in terms of gold, it is a very great question whether they would not be more misleading to people than they are to-day.

The next speaker was Mr. Longstaff. He made some reference to depreciation of fixed assets. I think he rather suggested that I had not dealt with them very fully in my paper. I have referred to my paper again and I think he will find, if he turns to pages 79 and 80, that I have really dealt with the particular points that he raised.

I very much appreciate the kind remarks that Mr. Holman made. One of the chief difficulties in preparing a paper like this is to make it simple enough for people who have not had much previous experience of exchange, and yet sufficiently informative and interesting to people who have had the practical experience. I am very glad to know that, in Mr. Holman's view at any rate, I have combined those two considerations. Mr. Holman also referred to the question of losses arising subsequent to the balance sheet by reason of the value of the floating assets going down. I quite agree that, as a measure of prudence it may be well and, in fact, justifiable, to make a reserve in that connection. All I

would say is that no one has yet been successful in persuading the Income Tax Authorities here to accept that method of arriving at the profit of the particular period. A third point also made by Mr. Holman was in connection with stocks of stores. He said he did not see why, if the market value of stores went down on the date of the balance sheet, the stores should be still valued at cost. I was considering, in that connection not stocks which are to be manufactured for re-sale, but stores of materials for use in the business itself, such as, for example, sleepers in the case of a Railway Company, railway lines and other engineering stores. It is not the practice, in a case like that, merely because the value of those stores which have been bought in fluctuating currencies is lower at the date of the balance sheet, to bring those materials into the balance sheet at that lower value. The general practice is to have regard to what they actually cost and when they are issued. Thus they form part of the expenditure on the line and they are charged up at what they cost and there is no question of writing off a loss on exchange in connection with assets such as that.

Mons. Van der Spil referred, as I understood him, to the question of a Dutch Company which had bought property over here in florins and where the rate of exchange subsequent to the purchase varied very much, I still feel that I must stick to my guns in regard to such a case as that and say that the Dutch company should consider how many florins it had actually paid for that property. It is a matter for consideration whether, in view of fluctuations of exchange, the Directors care as a matter of policy, to write that asset down ; but when one gets on to the question of current value, one is on entirely different ground. I would suggest that we must adhere to the basis which is always adopted over here in regard to such assets, namely, that you state them at their cost and you maintain them in the balance sheet at that, subject to what you may consider necessary to write off for depreciation. The question of what it may cost to replace them at some subsequent date, that cost being either greater or less by reason of exchange fluctuation does not enter into that particular problem.

The only other remark I would like to make in closing is to say how very much I appreciate the kind comments of Mr. Cash, especially, sir, as I was an articled clerk of his something like 30 years ago and he taught me a great deal of what I know now.

THE CHAIRMAN : Ladies and gentlemen, before leaving the Chair, I want to express my personal thanks to Mr. Holman for his complimentary

remarks about Holland. Secondly, I want to thank Mr. Cutforth for the most instructive paper that he gave us. He reminded us that this is a very difficult matter and I may say it is a problem that has faced us in Holland for many years. We have a currency in the Dutch East Indies which is not the same as our home currency. Mr. Cutforth gave expression not only to compliments to Holland, but to views which are new to us in many respects. I express my thanks to those who have taken the floor and given us their opinions on Mr. Cutforth's paper and now I declare the session closed and it will be opened at 3 o'clock for Sir Albert Wyon's paper. Thank you.

TUESDAY, 18th July, 1933

Afternoon Session

CHAIRMAN: COLONEL ROBERT H. MONTGOMERY

(United States of America).

HONORARY } MONS. J. FUKÁTKO (Czechoslovakia).

CHAIRMEN } MR. WILL APPLETON (New Zealand).

PAPER

“Holding and Subsidiary Companies”

SIR ALBERT W. WYON, K.B.E., F.C.A.



COL. R. H. MONTGOMERY, C.P.A.

HOLDING AND SUBSIDIARY COMPANIES

ACCOUNTING PRINCIPLES INVOLVED IN THE TREATMENT OF EARNINGS AND VALUATION OF HOLDINGS

BY

SIR ALBERT W. WYON, K.B.E., F.C.A.

Problems relating to the accounts of Holding and Subsidiary Companies form an appropriate subject for discussion at this international gathering, as to some extent they arise from the fact that the operations of many commercial undertakings are carried on in more than one country. The foreign subsidiary presents all the problems of the domestic subsidiary and some additional difficulties, especially since the partial breakdown of the exchanges which we have witnessed in the recent past. Moreover, increased public interest in the subject has been aroused in more than one country in the last year or two as the result of disastrous failures of groups of closely allied companies.

The subject is a difficult one, and in attempting to deal with one phase of it to-day I cannot fail constantly to be reminded of the loss we have all sustained through the death of Sir Gilbert Garnsey, who was to have prepared a paper upon this subject to be submitted to this Congress and who, by reason both of his brilliant gifts and his long-continued interest in the subject, was especially well fitted to do so.

You will note that I have been asked to deal with accounting principles, and questions of law will only be touched upon incidentally as may seem necessary.

As regards existing law, so far as I have been able to ascertain, the attempts of legislatures to deal with the subject have been few and ineffective. I cannot forbear mentioning as an illustration the

legislation in this country embodied in the Companies Act, 1929. That Act requires that certain particulars shall be disclosed to the members of a holding company relating to the trading results of its subsidiaries. The particulars briefly epitomised are as follows : A statement signed by directors is to be annexed to the balance sheet of the holding company stating how the profits and losses of the subsidiary company, or where there are two or more subsidiary companies, their aggregate profits and losses, have, so far as they concern the holding company, been dealt with in that company's accounts, and it is required in particular that the statement shall contain information as to how and to what extent (a) provision has been made for the losses of a subsidiary company either in the accounts of that company or of the holding company or both, and (b) losses of a subsidiary company have been taken into account in arriving at the profits and losses of the holding company. It is specifically provided, however, that it shall not be necessary to specify the amount of the profits or losses of any subsidiary company or the actual amount of any part of such profits or losses which has been dealt with in any particular manner.

I venture to think that the particulars required by the Act to be disclosed are of so general and vague a character as to be quite insufficient to supply shareholders with the information necessary for them, if they are to have a just view of the earnings of the enterprise in which they are interested and of its prospects. The provisions which I have epitomised may indeed have the unintended effect of providing justification for directors who wish so to prepare the accounts of a holding company as to conceal from those chiefly interested the actual results of its activities.

Definition of Holding Company.

In my experience, which dates back a good many years, the term "holding company" was first used to describe a company formed for the express purpose of combining the interests of a number of companies or firms carrying on similar or related businesses. The process consisted in the incorporation of a company and the issue by that company of its shares in exchange for the shares (in some cases the ordinary shares only) of the existing

companies, any firms proposed to be acquired being converted into companies for the purpose. The business of the holding company was confined to the supervision of its subsidiary companies and the receipt and distribution of dividends received from them.

Since those early days the conception of a holding company has been widened, and now includes companies which, in addition to holding interests in subsidiary companies, may carry on very important business operations on their own account. A subsidiary company may represent a business acquired, or what was formerly a part of the business of the holding company or of other subsidiary companies, or perhaps even a mere device to facilitate financial operations or to avoid publicity.

The term "subsidiary company" is to-day not restricted to companies of which all the ordinary shares are owned by the holding company. It is applied variously, but I would say that a fair definition of a subsidiary company would be a company of which the holding company possesses voting control either through a shareholding in the subsidiary itself or through shareholdings in another company or companies. British accountants will realise that this definition is wider in its scope than the definition with which they have been provided in the Companies Act, 1929, since the statutory definition in that Act is not so framed as to include sub-subsidiary companies.

The facts that subsidiary companies themselves have subsidiary companies and that subsidiary companies may be incorporated in a jurisdiction different from that of the holding company make the problem exceedingly complex.

The wholly owned subsidiary company and the subsidiary company in which only a majority interest is owned, stand on different bases.

For practical purposes it seems to me that subsidiary companies may be classified into groups—at the one extreme are companies which are wholly or substantially wholly owned by the holding company—at the other extreme, companies in which the holding company controls only a bare majority of the voting power. Between these limits a third category may perhaps be formed, comprising

companies in which the holding company's interest is sufficiently large to give it effective control of the subsidiary for all purposes, including winding-up, sale or amalgamation, for which purposes I believe in most countries more than a mere majority is needed : in Great Britain the necessary majority may be put at 75 per cent.

The rules which may properly be applied to the accounts of a subsidiary falling within one of these categories may not be applicable, or not applicable without modification, to a subsidiary of another class.

I think also that it would be unsafe to assume that foreign and domestic subsidiaries stand on precisely the same footing. The difference in status becomes immediately apparent when such untoward events happen as an outbreak of war or the restriction of exchange transactions.

It will, I think, be helpful therefore to consider the subject before us to-day, first in relation to domestic companies wholly (or substantially wholly) owned, and to pass later to any considerations applicable specially to the cases of companies merely controlled, and foreign companies.

The Two Sections into which the Subject is Divided.

The title of this paper was prescribed for me by the Executive Committee, and I think there is significance in the fact that of the two sections into which the subject is divided "earnings" comes first and "valuation," that is, statement of assets, takes second place.

I say it is significant because, in this country at any rate, it has been the practice to regard the statement of earnings, that is the profit and loss account of a company, as of much less importance than its balance sheet. It is true that the law which previously required only the preparation, registration and circulation of a balance sheet, now directs that a profit and loss account shall be prepared, but there is no statutory obligation as there is in the case of a balance sheet, to circulate it to shareholders (or to specified descriptions of shareholders) ; the law is sufficiently complied with if such an account is prepared and laid before the general meeting of shareholders. I am not lawyer enough to tell you precisely how this ceremony is performed and what its value may be, but a com-

parison of the requirements of British law relating to the two accounts seems to indicate that the balance sheet is viewed as an account of greater importance and of greater informative value to shareholders than the profit and loss account. When I come to the latter of the two sections into which my subject is divided, I shall say a very few words regarding the limitations of balance sheets—the matter is too large to discuss at length in a paper dealing with holding and subsidiary companies—and when the fact of these limitations is taken into account one is forced, I think, to the conclusion that insufficient stress has been laid on profit and loss accounts and that hitherto too large a share of public attention has been bestowed on statements of assets and liabilities.

PRINCIPLES INVOLVED IN THE TREATMENT OF THE EARNINGS OF HOLDING AND SUBSIDIARY COMPANIES

I hope you will agree with me that the profit and loss account of a commercial enterprise should be so framed as to set forth with as near an approach to accuracy as possible the results of its business operations during the period to which the account relates, and that this principle should be applied to all companies, whether their business is carried on or partly carried on through subsidiary companies or not.

Wholly owned Subsidiaries

Wholly owned subsidiary companies, though in law separate entities, are in fact from many aspects nothing more than branches of the holding company, and I would lay down as a general principle the rule that the most correct accounting treatment of the earnings of such companies by the holding company is that which produces the same income as would be shown if the branches did not exist as separate legal entities.

I am aware that it is the practice of some holding companies to take up in their accounts the entire profits of their subsidiaries during the same period, whether declared in dividend or not, and this practice has the merit of showing clearly the aggregate of the profits earned by the organisation during the period. On the other hand, the practice results in the inclusion, as an asset in the

accounts of the holding company, of profits of subsidiaries which have not been and may never be distributed.

When the practice is adopted the holding company should regard as not available for dividend to its own shareholders any portion of its revenue surplus which consists of undistributed profits of subsidiaries and a note may usefully be appended to the balance sheet showing how much of the surplus is composed of such profits.

Under British law, and I suppose under the law of most other countries, the profits of a subsidiary company do not become the property of the holding company except in so far as those profits are properly declared as dividend. It is usual here to treat profits so declared as profits of the holding company in one of two ways, viz. either for the period during which the dividends are declared or for the period in respect of which they are declared.

The latter is the better alternative as it tends to bring into the same period the results of the undertaking as a whole and for the same reason it is desirable that wherever possible the financial periods of the holding company and of its subsidiaries should coincide.

Where the dividend of a subsidiary is partly derived from profits earned prior to the period in respect of which it is declared, the extent to which the dividend is so derived, at all events where it is considerable, should be disclosed in the accounts of the holding company either by adding the portion of the dividend paid by the subsidiary out of profits earned prior to the financial period to the undivided profits of the holding company at the beginning of the period, or by way of note in the accounts of the holding company.

There are cases in which only a part of the profits earned by a subsidiary company is declared in dividend and the remainder is carried forward in its accounts as undistributed. Where it is the practice of a holding company to take credit in its profit and loss account only for dividends declared by its subsidiaries the result is that the earnings of the undertaking, as disclosed in the accounts of the holding company, are understated, and this fact must be recognised and must receive consideration in the light of the circumstances of each case. The commercial community, however, and I think I may say the law in this country, look on an understatement of profits

with a leniency which is not extended to an over-statement. If I were called upon to give my advice it would be to the effect that a holding company should make a practice of seeing that each of its wholly owned subsidiary companies declared in dividend for each financial period the whole of the profits earned by it during that period. When, however, profits of subsidiaries reserved from distribution are made use of to supplement the dividends of later and perhaps less prosperous periods, considerations arise which have been dealt with in the remarks already made upon the treatment by a holding company of dividends paid by a subsidiary partly or wholly out of profits earned prior to the period for which its profit and loss account is made up.

Where the dividend of a subsidiary is paid (or partly paid) out of profits earned prior to the acquisition by the holding company of its interest in the subsidiary, such dividend (or part of a dividend) should be capitalised in the accounts of the holding company preferably by being written off the book cost of the shares of the subsidiary, since the revenue fund out of which the dividend is paid formed wholly or partly at the time of its acquisition part of the assets in which an interest was acquired. It is useful as a method of giving effect to this principle in the case of a wholly-owned subsidiary, to carry to a separate account in the books of the subsidiary, any profits undivided at the date of the acquisition.

It follows that where the profit and loss account of a subsidiary company is in debit at the time of the acquisition of shares in it by a holding company, such pre-acquisition losses need not, so far as the holding company is concerned, be made good out of subsequent profits and so far as the subsidiary is concerned, I think that in British law it is permissible for dividends to be declared out of such subsequent profits without reference to prior losses.

Where a subsidiary company is being financed by the holding company, it is sometimes the practice for the subsidiary to credit the holding company in current account with the dividends declared by the subsidiary company. I am disposed to think that it is preferable that all such dividends should be paid by the subsidiary by cheque or warrant on its bankers in the usual way, and that if this

leads to a depletion of the funds of the subsidiary company to an extent requiring those funds to be supplemented, a further advance should be made by the holding company, not necessarily equal to the amount of the dividend, but regulated by the requirements of the subsidiary company.

The principles which have been suggested as applicable to profits earned and to dividends declared by subsidiary companies apply equally to the profits and dividends of companies subsidiary to subsidiary companies.

So far I have been dealing with the case of subsidiary companies which are earning profits, but important considerations apply to the case of such companies as may be incurring losses. It is in the highest degree desirable that provision shall be made for such losses out of the profits of the holding company or that they shall be added to its losses where that company is itself not earning profits, since otherwise the accounts of the holding company will not disclose, as I have said they should disclose, the results of the organisation as a whole. In considering the amount of the provisions to be made for such losses, the holding company may properly set off any undrawn profits for the same period remaining in the accounts of any other subsidiary or subsidiaries.

I have sometimes heard the opinion expressed that when taking into consideration revenue losses incurred by a subsidiary, a holding company may treat such losses as offset by appreciation which may be deemed to have arisen in the realisable value of the properties and other fixed assets of the subsidiary. Estimated appreciation in assets is no part of the trading revenue of the year and cannot be set off against trading losses in computing the earnings of the group.

An exception to the rule that a holding company should make provision for the losses of its subsidiaries may fairly be made in the case of losses incurred by a subsidiary where the book value of the holding company's interest in the subsidiary, whether in the shape of the cost of shares or debentures or of advances, has been wholly written off or provided for in the accounts of the holding company. This exception, however, covers only cases of subsidiaries which have in effect been abandoned by the holding company.

In any case in which the financial period of the subsidiary ends at a date considerably before that of the financial period of the holding company, steps should be taken to ensure that if it seems probable that the subsidiary has made a loss in the intervening period, suitable provision is made in the accounts of the holding company.

Those who have charge of the preparation or criticism of the accounts of holding companies should ascertain the extent to which, if at all, the profits of subsidiaries included in those accounts consist of profits earned otherwise than in the ordinary way of business. It is as important that abnormal profits or transfers from inner reserves of relatively material size which reach the holding company through the medium of a subsidiary should be disclosed in the accounts of the holding company as that such profits or transfers originating in the accounts of that company, should be disclosed.

There are a few other matters relating to subsidiary companies which require consideration in the preparation of the profit and loss account of a holding company.

Firstly, the profits taken up in the accounts of a holding company as having been derived from a subsidiary company sometimes take the form, or partly take the form, of interest on advances on loan or on current account, made by the holding company. It is essential that such interest shall not be included in the profits of the holding company unless there are profits of the subsidiary available for the payment of such interest. If there are no such profits, the interest should be held in suspense in the accounts of the holding company and taken credit for as profits only when there are profits of the subsidiary available for the payment of it. Where interest payable by a subsidiary is provided out of the profits of some period not concurrent or approximately concurrent with that of the profit and loss account of the holding company, the suggestions already made with regard to dividends paid by subsidiaries out of the profits of prior periods apply.

Secondly, where goods are sold to a holding company by a subsidiary at a profit, the profit on goods remaining unsold by the holding company at the date up to which its profit and loss account is prepared should be reserved in suspense in the accounts of the

holding company, leaving the subsidiary to treat the profits on such sales as available for dividend.

The same principle applies to the case of goods or services supplied by a subsidiary for the purposes of capital outlay by the holding company. The holding company should charge its capital expenditure accounts only with the cost of supplies actually incurred by the subsidiary. •

This principle is properly applied to all dealings between companies comprised in a group which result in profits appearing in the accounts of those companies.

Thirdly, it is of importance that where administrative or other expenses are incurred for the common benefit of two or more members of a group of companies, they should be distributed among those companies upon a system intended to be continuously followed and designed to distribute such expenses as fairly as possible.

Fourthly, subject to any modification necessitated by differences in conditions, the accounts of subsidiaries should be prepared on lines similar to those adopted by the holding company in such matters, for example, as provision for depreciation, amortization of leaseholds and other wasting assets, valuation of stocks and of marketable securities and provision for liabilities. In short, so far as circumstances permit, the accounts of the holding company and its subsidiaries should be drawn up as if they were the accounts of one undertaking, as indeed they are in all but the technical difference due to their existence as separate legal entities.

To give full effect to the principle it is necessary that the aggregate charge in the accounts of the holding and subsidiary companies for depreciation, amortization of leaseholds and other wasting assets, should be the same as if those assets were owned directly by the holding company. Let me illustrate the point :

Assume the case of a subsidiary company owning nothing except a leasehold which stands on its books at an amount equal to its share capital, say £100,000. Suppose that the shares of the subsidiary company stand on the books of the holding company at their cost of £300,000. Provision for amortization of the leasehold should, I think, be computed on the basis of £300,000, one-third of the charge

being taken up on the books of the subsidiary company and the remainder on the books of the holding company.

Most instances requiring the application of the principle will not be as simple as that of the illustration given above. For example, in many cases the premium paid by a holding company for the shares acquired in a subsidiary will be represented to some extent at all events, by the acquisition of goodwill, but wherever provisions for amortization or depreciation are based upon the book values of assets, those values should be ascertained by reference to the price paid by the holding company rather than to the figures at which the several wasting assets are standing in the books of the subsidiary company. If the point is overlooked, profits of the holding company may be overstated and opportunity will arise for abuses through the formation of subsidiary companies formed to acquire from a holding company properties at values materially less than their true cost.

Subsidiaries controlled but not wholly owned.

I will now briefly consider the question how far the suggestions made in respect of wholly owned subsidiaries need to be modified in the case of a subsidiary company in which an interest is held by shareholders other than companies within the group. In such a case the dividend policy should be determined by the position of the subsidiary company and not by consideration of the interests of the holding company alone. Special care should be taken to ensure that the inter-company transactions, including the apportionment of administrative and other common expenses between the subsidiary and other companies in the group, should be effected as between independent companies. It would still be desirable for the holding company to carry in suspense any inter-company profit on the transactions with such a subsidiary which has not been realised from the standpoint of the group as a whole, but the profit so carried in suspense may fairly be limited to a proportion equal to the proportion of the holding company's interest in the subsidiary.

When losses are incurred by a subsidiary company which is not wholly owned, a point may be reached where the accumulated losses of the company exceed its share capital. In such an event it is

important to remember that the outside interests cannot be called upon to bear further losses and the whole of these must be borne by the holding company itself unless it has made full provision in respect of its shareholdings and sufficient provision in respect of its advances and has abandoned the subsidiary or has made arrangements whereby the outside interests provide their share of the losses.

The comment which has been made upon the practice of taking up in the accounts of a holding company the undistributed profits of its wholly owned subsidiaries applies with even greater force to the undistributed profits of subsidiaries only partly owned.

With these modifications the principles suggested as applicable to wholly owned companies apply also to companies incompletely owned.

Foreign Subsidiaries.

The foregoing observations upon the treatment of the earnings of subsidiary companies in general are to be considered as applicable to foreign subsidiaries, but mention should be made of one or two points specially affecting subsidiary companies incorporated abroad. Holding companies should take up in their accounts the amounts of any dividends declared by such companies converted into the currency used by the holding company at a proper rate. Whether that rate should be the rate ruling at the end of the financial period, or the average of the rates ruling throughout the period, or the rate ruling on the date when the dividend is declared, are questions for consideration in the light of the peculiar circumstances of each case. It must not be forgotten, too, that in some countries at the present time the governments have fixed official rates of exchange which, however, so far as my information goes, are not always effective.

Whether such dividends should be treated as divisible profits by the holding company may also require special consideration. In the present unhappy financial condition of the world, difficulties often arise in the transmission of funds from one country to another, and where such difficulties exist it would be well that the holding company, though taking up in its accounts dividends declared, should not treat them as divisible profits but should hold them in suspense until they are received.

ACCOUNTING PRINCIPLES INVOLVED IN THE VALUATION OF HOLDINGS

I now turn to the second of the two sections into which my subject as set forth in the title of this paper falls, namely, the Accounting Principles involved in the Valuation of Holdings, and before proceeding to deal with this part of my subject in any detail, I desire to make some observations induced by the use of the word "valuation." If I remember aright there was an Act of Parliament relating to finance, passed in this country some years ago, with regard to which it was said, with what truth I have not concerned myself to ascertain, that it contained twenty-seven different definitions of the word "value." In any event, it will be generally agreed, I think, that the word is susceptible of various shades of meaning. For instance, there are things which have a sentimental value, there are things which are of no value except to the person to whom they belong, there are things the value of which differs materially as the result of varying conditions, there are values of things as "going concerns" and there are "break-up" values.

I think, however, that to the ordinary person not specially versed in the technicalities of business, the word "value" as applied to a thing means what that thing could be sold for.

In this sense the word "valuation" is not applicable to some at least of the classes of assets which figure in a great proportion of balance sheets.

I think it of importance that it should be realised how misconceived is the notion, all too common, that the balance sheet of a commercial undertaking purports to set forth the "value" of the assets of that undertaking.

In so far as those assets are what are generally known as fixed assets, to endeavour to set forth in a balance sheet their sale value would be irrelevant even if it were not also impracticable. By fixed assets I mean assets acquired and intended to be retained in relative permanence for the purpose of carrying on the business of the undertaking and not for the purpose of realisation at a profit. It must not be forgotten that "valuations" are estimates which even although they are made, as they often are, by persons of the highest skill and integrity, remain nothing more than estimates.

It is only possible to ascertain value in the sense in which I have suggested that it is generally understood, by entering into a good contract for sale with a solvent party. I know how useful it would be in practice to business men and to investors if, from an intelligent perusal of the balance sheet of a commercial undertaking, they could obtain information as to the aggregate realisable value of the undertaking—what is sometimes called “net worth”; but balance sheets do not purport to give such information, and the plea of accountants that balance sheets should not be regarded as doing so is no mere shabby evasion.

That plea rests not only on the fact that balance sheets are not designed to give such information but also on the equally important fact that in a large proportion of cases values, in the sense which I have attributed to the word, are not ascertainable, so far, at all events as fixed assets are concerned.

The interest of a holding company in its subsidiary normally falls into the category of fixed assets as having been acquired not for resale but to be retained for the purpose of carrying on the business of the undertaking, and as such should be stated on the basis of cost, it being understood first, that due allowance is made in the accounts of the subsidiary company for the maintenance of its fixed assets; second, that any trading losses of the subsidiary are provided for in the accounts of the holding company; and third that any profits of the subsidiary brought into the accounts of the holding company, either by way of dividend or otherwise, which were earned by the subsidiary prior to its acquisition by the holding company, are deducted in computing cost.

The fact, however, must not be lost sight of that the investing public is disposed to look upon shares and debentures in a light different from that in which they regard such fixed assets as goodwill, land, buildings, plant, machinery and the like. They realise, I think, that directors and auditors are not usually in a position to form an opinion of the realisable value of such assets as goodwill, land, &c., and that, if they could, it would not be relevant so long as there was no intention to dispose of them, but they are apt to take a different view regarding shares and debentures,

whether they represent interests in subsidiary companies or not.

In the case of wholly owned subsidiaries, since the holding company's interest in effect represents the ownership of the assets of the subsidiary company (which may include goodwill, land, buildings and the like) the distinction is quite unfounded. Those responsible for the accounting of a holding company are not called upon to consider or attempt to set forth the realisable values of the holdings in subsidiary companies.

Holdings in partially owned subsidiaries may stand on a footing different from that of wholly owned companies, particularly if the outstanding interest is large and reliable market quotations are available in respect thereof. But even in this case a quotation which may properly be deemed a measure of the value of a small number of shares may not be equally indicative of the true value of a majority holding.

FORMS OF ACCOUNTS

At the risk of going somewhat beyond the subject assigned to me, I should like to say a few words on the subject of the form in which the relevant facts in relation to subsidiary companies can best be communicated to the shareholders of the holding company.

In any attempt to deal with this question I think that two facts should be borne in mind. The first is that where investments in subsidiary companies are of material importance reasonable information in regard to the earnings, assets and liabilities of those companies is as essential to a proper understanding of the financial position of the holding company as information in regard to the earnings, assets and liabilities of the holding company itself. The second is that the character of subsidiary companies and the nature and extent of the interest of the holding company therein vary to so great an extent that no uniform rule can be laid down which could be expected to fit every variety of case.

Various forms of account may be suited to various conditions, but I will name a few which suggest themselves to me.

The best form to be adopted is, I think, the presentation of the statutory balance sheet and accounts of the holding company, accompanied by the accounts of subsidiary and sub-subsidiary com-

panies, with an explanation of the manner in which, and the extent to which the profits of the subsidiaries have been brought into the accounts of the holding company.

There are cases, however, in which the number of subsidiaries owned or partly owned by a holding company is so large as to make this plan impracticable, and in such instances it is not unusual to supplement the statutory accounts of the holding company by combined statements of earnings and of assets and liabilities of the holding company and of its subsidiaries and sub-subsidiaries. This form has the advantage of presenting a comprehensive view of the facts but is open to serious objection, so far as the statement of assets and liabilities is concerned, in that the inference apparently to be drawn from the form is that the creditors, secured and unsecured, of the several companies forming the combination, have a common fund, namely the aggregate assets of the combination, to look to for the payment of their debts, which is not the fact. A further serious objection exists where the subsidiaries or some of them, are not wholly owned. It is necessary in such cases when preparing combined statements, to deduct from the aggregate earnings a sum to represent the share of the outside interests in those earnings and to set up a liability upon the combined statement of assets and liabilities to represent the interest of outside shareholders. Such an account should not be considered as a substitute for the statutory balance sheet which should be drawn up so as to show the financial position of the holding company as a legal entity.

Another plan which is sometimes adopted and which has much to recommend it, is to include in the directors' report a statement showing the aggregate profits of the subsidiaries and the proportion of them which has been brought into the accounts of the holding company. It is useful to add to such a statement a note of the amount of aggregate profits or losses since the date of acquisition carried forward in the accounts of the subsidiaries. Such a plan though giving useful information in regard to earnings, is deficient as supplying no information in regard to the assets and liabilities of the subsidiaries, a fact which may be of great importance, particularly if any of the subsidiaries have heavy secured liabilities

outstanding. A modification, or perhaps I should say an attenuation, of this last mentioned plan is to add a note in the balance sheet of the holding company below the entry of its investments in its subsidiary or subsidiaries, to the effect that the net earnings of those companies for the financial period represent a specified percentage per annum on book value.

AUDIT OF THE ACCOUNTS OF HOLDING AND SUBSIDIARY COMPANIES

I have already taken the risk of transgressing the limits of my subject, but I must beg to be forgiven for incurring the risk again. I should like to make a very brief reference to the audit of the accounts of holding and subsidiary companies. It is usually advisable that the same auditors should be employed to audit the accounts of all companies within a group and, indeed, there have been instances in which, if the same auditors had been employed to audit the accounts of all the grouped companies, irregular and perhaps improper transactions might have come to light at an early stage and much loss and trouble have been saved. There may, however, be difficulties or inconveniences owing to special conditions in making such an arrangement, but where the auditors of a holding company are not also auditors of the subsidiary companies or at all events of those of them which are of material importance, they should have access to the detailed accounts of the subsidiary companies and should be empowered to call for full explanations from the directors and auditors of those companies of any matters in the accounts which they may consider require explanation.

CONCLUSION

I hope that the foregoing remarks will not be without their value if only as a means of stimulating discussion of a subject of importance to the financial world. It is, too, a subject of growing importance in these times of large aggregations of capital in companies no small proportion of the activities of which is carried on through the medium of subsidiary companies. The fact that a part, sometimes the greater part, of the operations of a large commercial undertaking is carried on through subsidiary companies tends, where

some such procedure as that suggested above is not adopted, to the concealment of facts which it is material that those interested in the organisation should know.

The practice of the formation of subsidiary companies and, I may add, particularly the formation of sub-subsidiaries, permits the carrying out of a policy of secrecy to a degree which would not be possible if the operations of an organisation were carried on through a single company.

The degree of secrecy which may be justifiable in the conduct of a business carried on by partners, all of whom are usually in frequent contact and are entitled to full information regarding the affairs of the firm (if they have not by express agreement waived their right to it) is out of place in a company the shareholders of which can look only to the accounts and the report (usually meagre enough in character) issued by the directors, for the particulars necessary to enable them to take an intelligent interest in the undertaking of which they are the owners. In addition to such opportunities of obtaining information they can, of course, attend the periodical meetings of the company, but any inquiries they may have to make must almost of necessity be based upon the information contained in the accounts and report supplemented possibly by a verbal statement made by the chairman.

I venture, then, in the case of holding and subsidiary companies to put in a plea for increased publicity. I am aware that a policy of secrecy is often defended on the ground of the necessity for concealing facts the knowledge of which might be of value to competitors. I think it is quite possible to place too much emphasis upon the risk of benefiting rivals as the result of the publication of particulars useful to shareholders. Trade rivals are, after all, not dependent mainly on the reports and accounts published by the directors of a company for information as to its activities and their results, and the omission to disclose what may prove to be material facts may have serious results for the shareholders.

The whole question is so important and so fraught with difficulty that it deserves the careful and constant attention of the organised profession of accountancy throughout the world.

In the United States of America the profession has made substantial progress in dealing with it, greatly aided by the New York Stock Exchange which has insisted on adequate disclosure in one form or another in relation to subsidiary companies. In Germany the newly formed Institute will, I am sure, approach the question in the broad spirit that has marked its initial activities. In Great Britain, as I have indicated, the practice is not entirely satisfactory and is bound to receive further consideration, and I should be quite prepared to learn that the same may be said of other countries represented at this international gathering.

The solution of the problems is not to be found in legislation, though laws more helpful than those now in force in this country could doubtless be devised. But laws cannot usefully set a standard of conduct such as directors and auditors truly concerned for the welfare of shareholders would wish to adopt, but only a minimum standard to which even the least conscientious must adhere or be subject to penalties. Neither directors nor auditors should be satisfied with bare compliance with such statutes. Nor should the accountant be content merely to adopt and follow public opinion ; in a field in which his experience gives him special competence he should aim to lead public opinion in the right direction.

To achieve our full measure of usefulness we must combine honesty, independence and care in discharging our responsibilities with a broad view of the limits of those responsibilities and a willingness to extend those limits to meet the changing needs of business and of the investing public.

DISCUSSION

THE CHAIRMAN : Lord Plender, ladies and gentlemen, the Session this afternoon is devoted to a discussion of the paper on " Holding and Subsidiary Companies, Accounting principles involved in the treatment of earnings and valuation of holdings." The paper will be read or summarised by Sir Albert Wyon.

SIR ALBERT WYON, K.B.E., F.C.A. : Mr. Chairman, ladies and gentlemen, as the paper which I have prepared upon the subject of holding and subsidiary companies—accounting principles involved in the treatment of earnings and valuation of holdings, has been circulated among you in the shape of a printed pamphlet there is no need for me to do anything more at the moment than say a very few words by way of summary. The subject of my paper is one, I think, which is worthy of the close attention of the accountancy profession, in view of the continually increasing tendency to carry on commercial undertakings through groups of companies. I need scarcely lay stress upon the importance of the accounts of such groups of companies being prepared in such a way as to disclose with as near an approach to accuracy as possible the true earnings and the financial position of the group considered as a whole. I have divided the consideration of the subject of my paper into two sections as is implied in the title—first, the principles involved in the treatment of the earnings of holding and subsidiary companies, and second, the accounting principles involved in the valuation in the accounts of holding companies of the interests owned by them in subsidiary companies. In dealing with the treatment of earnings I am making a number of suggestions relative to the incorporation in the accounts of a holding company of the profits earned by its subsidiaries having for their object the fair statement of the results attained by the group as a whole for the period to which the accounts relate. I realise that my suggestions, or at all events some of them, may not meet with acceptance on all hands, but the object aimed at will, I believe, appeal to all ; the only direction, I think in which differences of opinion are likely to arise being as to the efficacy of the suggestions made for attaining that object. The second section of

my paper, namely that which deals with the valuation in the accounts of holding companies of their interests in subsidiary companies, is one upon which different views may well be held by members of our profession, but my view is that the interests of holding companies in subsidiaries are of the nature of fixed assets and as such are not properly the subjects of periodical revaluation in the same way as are assets which are held for the purpose of realisation at a profit. I am saying a few words respecting the forms of account best adapted to disclose the financial position of a group considered as a whole, but the subject is somewhat beyond that covered by the title of the paper which, as I have said, was prescribed for me by the Committee and I have therefore only touched upon it very briefly. While I cannot hope to have laid down principles of universal application on this important subject I hope that the remarks contained in my paper will assist in inducing a discussion of the principles touched upon.

I now leave my paper before you for criticism and comment.

THE CHAIRMAN: The discussion will be opened by Mr. Maurice Peloubet, of the United States.

MR. MAURICE E. PELOUBET, C.P.A. (United States of America): Mr. President, ladies and gentlemen, it is a bold thing for a pupil to venture to discuss the work of his teacher and the only thing which gives me courage to do this is the recollection of the consideration, the kindness, and most of all the patience which the teacher showed when the pupil was absorbing, so far as he could, the knowledge and wisdom of the teacher.

It was my good fortune to be for several years associated both in the United States and England with the great firm which Sir Albert Wyon heads. It is not unusual for an accountant to have experience in both countries, but to have the American experience first and British experience afterwards is rather unusual and the point of view thus developed is also perhaps unusual as it means, in effect, becoming familiar with an out-growth or development first and the source of the development afterwards.

There are so many things in the paper before us which are admirable and with which we all agree that it would take some time even to mention them and I hope everyone will understand that it is only the points where there is some possibility of doubt or even disagreement that will be discussed.

Sir Albert seems to consider that the ideal situation in the accounts of a holding company is where the books of the holding company itself

express correctly the results of the entire enterprise. I am not quite sure whether it is a fair statement, but it seems to me that in the paper under discussion an attempt is being made to write into the books of the holding company what is essentially a consolidated income and surplus account. While this is a most interesting suggestion and possibly practicable where only a few subsidiaries with a relatively simple financial structure are concerned, I confess myself somewhat doubtful of its theoretical soundness or practical desirability where numbers of subsidiaries with interlocking stock ownerships and organised in different countries or under different legal jurisdictions are in question.

With one exception all of the advantages of the method proposed would be gained by means of properly constructed consolidated accounts. The one exception is, of course, that the legal claim which any particular creditor or group of creditors has on any particular asset is not shown. However, are we correct in assuming that published accounts are drawn up primarily or even in a secondary sense for the benefit or information of creditors? Is it not more correct to consider that the published accounts of a company are designed first of all for the information and protection of the proprietors—that is of the shareholders?

Whether it is possible, no matter how the underlying accounts are stated, to draw up a balance sheet of a large enterprise of complicated financial structure so that the same accounts may give the creditors of individual companies and the shareholders of the holding company the information they both need is to my mind a highly debatable question. That both groups interested in the enterprise are entitled to the information necessary for their protection is obvious and the only question is: how this can best be given and whether an attempt to make one statement answer for all purposes may not in some way fail to protect the interests of one or the other of the parties.

In the paper under discussion it is suggested, in order to show on the books of the holding company the results of the consolidated enterprise that wholly owned subsidiaries should declare in dividends 100 per cent. of their profits each year. It is true that, with the exception of providing for losses, this would show a total profit which would be the correct figure for the consolidated enterprise providing all subsidiaries were 100 per cent. owned. However, it is as is pointed out in the paper, most unlikely that all the subsidiaries would be in a position to pay such dividends in cash.

If, as not infrequently happens, an integrated enterprise includes

producers of raw materials derived from wasting assets, such as quarries or mines; plantations or other agricultural undertakings and manufacturing or fabricating plants; each unit of which is a separate company, we are forced to consider the varying financial requirements and capabilities of the different companies.

The quarries and mines will probably have more cash receipts than book profits, the excess representing either realisation of deposits purchased or discovered; the plantations and other agricultural undertakings may be able to pay out all of their earnings, but not much more, and the fabricating plants, which generally require a proportion of their earnings to be reinvested in new machinery or increased facilities, will be able to pay out only a portion of their book profits.

To overcome these difficulties it is suggested that the dividend be paid in cash and the amount which would have to be turned back to the subsidiaries for re-investment, either in fixed or current assets, should be treated as an advance by the holding company to the subsidiary.

It is hard to see how this somewhat artificial method of procedure could fail to create difficulties of several sorts. In the first place it would be very difficult for the shareholders or creditors of the holding company to distinguish between those advances or those parts of advances which represented the current assets, that is, which could reasonably be expected to be repaid within a short time, from those advances which represented profits reinvested in subsidiaries and which could not be repaid so long as the subsidiary continued to operate.

There also seems to be a possibility of abuse present in the ability of some companies to pay more currently to the parent or holding company than their profits declared as dividends.

Let us suppose this situation :

	Book Profits \$	Cash not required in the business \$
Mexican Quarries S.A.	500.000	750.000
Tennessee Nickel Corporation ..	750.000	1,100.000
Florida Rubber Estates, Inc. ..	250.000	250.000
Arizona Cotton Plantations, Inc. ..	200.000	150.000
Superb Manufacturing Co., Inc. ..	1,200.000	700.000
	<u>\$2,900.000</u>	<u>\$2.950.000</u>

The holding company would, under the plan proposed, have dividends of \$2,900.000—credited to its income account and would have to repay, as advances :

	\$
Arizona Cotton Plantations, Inc.	50.000
Superb Manufacturing Co., Inc.	500.000
	<hr/>
	\$550.000
	<hr/>

On the other hand, the holding company would naturally receive advances from :—

	\$
Mexican Quarries S.A.	250.000
Tennessee Nickel Corporation	350.000
	<hr/>
	\$600.000
	<hr/>

Under these conditions the holding company could pay out the entire declared profits of subsidiaries in dividends to the stockholders of the holding company as it would have both the book profits to declare the dividends from and the money with which to make the payment. Such a procedure would, I think, be wrong but, if we once admit the premise that total book profits should be declared as dividends (such dividends to be paid in cash) and that any amount so paid in excess of the subsidiary's ability to pay should be returned to it as an advance, it would be difficult to attack, on any moral or legal ground, the corollary that any subsidiary possessing funds in excess of its needs should advance them to the holding company. If this were admitted nothing could stop the holding company, in cases like that outlined, from making a dividend payment which is clearly legal and, to my mind, just as clearly improper.

If consolidated accounts on the usual basis were prepared the income account of the holding company would be credited with dividends from :—

	\$
Mexican Quarries, S.A.	500.000
Tennessee Nickel Corporation	750.000
Florida Rubber Estates, Inc.	250.000
Arizona Cotton Plantations, Inc.	150.000
Superb Manufacturing Co., Inc.	700.000
	<hr/>
	\$2.350.000
	<hr/>

This \$2.350.000—would represent the total amount payable to share-

holders of the holding company if each subsidiary had to stand on its own feet financially. The difference of \$550,000—would remain as an increment to consolidated surplus and would be shown as such in the consolidated accounts. It could not be paid out in dividends to the shareholders of the holding company until such time as the individual subsidiary had sufficient cash as well as profits.

No such procedure as that outlined would, I am sure, be countenanced by the author of the paper under discussion but I am afraid that if the general principle put forward were adopted the auditor might have some difficulty in arguing against this apparently logical extension of his ideas.

A correctly drawn up consolidated balance sheet and income account meets all these objections and the reason seems to be that the consolidated accounts are frankly and plainly statistical statements or, if we do not like this description, we may say that they are the representation of an economic unit rather than a statement of assets on one hand and the various claims against those assets on the other.

In the United States we do not always regard the published accounts of a company as being the directors' accounts which we are called on to verify. As a rule the auditor has more or less to do with the construction and form of the accounts as well as their audit. In British practice, at least so far as the audits of single companies are concerned, accounts are prepared by the directors and unless the audit discloses discrepancies for which the directors' accounts must be adjusted the auditor has completed his duty when he is able to attach the statutory certificate to the directors' accounts. When it comes to consolidated balance sheets and in many cases the accounts of holding companies, the situation is radically different. Consolidated accounts are not and cannot be directors' accounts as there can be no directors of an extra legal entity which is set up for statistical and financial purposes only, but which has no legal being of its own. One cannot be a director of an accounting consolidation of a dozen companies any more than one can be a director of an index number or an industrial census. Consolidated accounts are the creation of the auditors, not in their capacity as auditors, but as accountants. They are auditors of the constituent companies but when these are brought together in a consolidated balance sheet and income account the work becomes a matter of construction rather than of verification and it is the accountants' responsibility to construct a picture of a number of enterprises all differing in some respect, but all forming part of one economic unit. This requires not only correct accounts for each con-

stituent company but also a separation of the accounts of the constituent companies as between those activities and functions which have to do with other units of the organisation and those which have to do with companies or individuals outside the organisation.

It is obvious that there can be no legal basis for procedure in such a situation. This fact not only does not relieve the accountant of responsibility but increases it. As where there are legal rights and duties the accountant can do nothing but express them. Where, however, most of the debatable points are decided on the basis of economic fitness or on fairness in acknowledging obligations which are not yet perfected to legal form the difficulties and responsibility are much greater.

All this is based on the proposition that consolidated accounts are primarily an accounting creation ; that they do exhibit correctly, when properly drawn up, the status of a certain economic unit but they do not represent the position of any one legal entity or of any one constituent element of the combination.

All the weaknesses and deficiencies of consolidated accounts, which certainly exist and can be clearly and easily demonstrated, may be overcome simply by admitting them and stating them clearly. While I, of course, agree with the author of the paper we are discussing that the ideal situation is to present a consolidated balance sheet of the entire enterprise and the legal balance sheet of the holding and constituent companies, this procedure is a practical impossibility where a consolidation involving say 50 companies is being considered. Here, it would seem, there is little doubt that the consolidated accounts are the proper means for the protection and information of the shareholders.

Holders of bonds or debentures are entitled to a clear statement of the assets to which they may look for repayment. If these assets consist of the property of a subsidiary company then it is the balance sheet of that subsidiary and that alone in which they are interested and a complete balance sheet or some other statement in sufficient detail should be given to them. Banks, merchandise creditors or unsecured creditors may also be entitled to the accounts of the particular company to which they have extended credit. This however is generally a matter of private understanding or agreement and does not affect the question of published accounts. There seem to be some dangers and there are certainly many complications involved in an attempt to show on one set of financial books the result of an enterprise which is held together by investments made by a holding company. It may be that some of the difficulties in-

volved in carrying out the suggestion contained in the paper under discussion are not as great as they seem to be and it may be that the desirable features of this method of treating holding company accounts are greater than they appear. I have, of course, given only my personal opinion and I would be happy to be convinced that I am wrong as such a method if it were possible, would make many things in connection with the accounts of a large and complicated enterprise much easier and simpler to handle.

While the detailed problems involved in the construction of consolidated accounts are outside the scope of this discussion a comparative view of the type of holding company accounts proposed and the usual consolidated accounts which cover the same ground necessitates the consideration of some points involved in the construction of consolidated accounts.

If all completely owned subsidiaries should declare their total annual profits in dividends no discretion would be left to the accountant when deciding on what completely owned companies should be included in the holding company's accounts.

Under the ordinary methods of consolidation this problem divides itself into two contrasting questions—first, what companies should be consolidated regardless of extent of ownership and second, what percentage of ownership is a proper basis for consolidation. Although it may not be the orthodox opinion it would seem that there might be cases where 100 per cent. owned companies should not be consolidated. Where a company is owned 100 per cent. but where the business is not a true part of the economic unit and is neither directly nor indirectly under the parent company's management the shares of that company should be carried as an investment. If a company manufacturing heavy machinery should sell a number of presses to a company in a novelty metal stamping business and was later forced to take over the capital stock of the latter company in payment for the machinery it had supplied, this would seem to be so far removed from the general business of the company that consolidation would not be indicated.

As to percentage in consolidation there is, of course, wide latitude. About the only valid argument for not consolidating a company which is clearly a part of the economic unit and is over 51 per cent. owned is the inconvenience and difficulty of handling large items of minority interest. In the United States there seems to be general agreement that ownership of 75 per cent. is a fair minimum for justifying consolidation

which view, however, is not shared by the United States income-tax authorities who now require ownership of 95 per cent.

It is interesting to see that the British practice in regard to percentage required for consolidation is substantially the same as that existing in the United States, and we should be glad to have our views confirmed by our British friends.

Under the plan proposed for holding company accounts the interest of the holding company in the profits of partially owned subsidiaries would be shown only to the extent of dividends declared by the subsidiary on the basis of an independent company and the usual elimination of unrealised inter-company profits would be made, although by another method.

The effect would be to show in the holding company's accounts all profits of completely owned companies but only those payable in cash where the ownership was less than complete.

If, to take the former example, the Superb Manufacturing Co., were 95 per cent. owned the income account of the holding company would be reduced, not by 5 per cent. of the profits of \$1,200,000 or \$60,000—but by \$535,000 being the \$500,000—of books profits not distributable in cash and \$35,000—being 5 per cent. of the \$700,000 the greatest possible dividend payable in cash.

Conversely if the same company were 95 per cent. owned and the remaining 5 per cent. acquired the holding company's income account would be increased by \$535,000.

There is no doubt that the hope expressed by Sir Albert that his remarks would stimulate discussions will be realised. I think we can all agree that there has seldom been a paper written on this subject which brings up more points which are doubtful or contentious and which deserve the most careful thought and the fullest discussion. Our responsibilities in connection with the enormous aggregates of capital and property which dominate most of the important industries is heavy and there is no one else to shoulder this responsibility or even, in any great degree, to help us with our problem. If we rely too much on either the lawyer or the engineer, who are usually our closest associates outside of our own profession, we are led into numerous and dangerous errors.

One of the first lessons which I learnt when I was fortunate enough to be associated with the writer of the paper we are now discussing and his firm was that the principal duty of the auditor was the exercise of his own judgment, uninfluenced by that of other persons, particularly interested persons, and this attitude is perhaps more necessary in connec-

tion with the accounts of large holding companies than in any other part of our work.

I think we are all in complete agreement with Sir Albert so far as the principles of correct and honest disclosure of all pertinent facts to all parties entitled to such information is concerned. Whether we all of us see eye to eye with him in matters of procedure is another matter. We may or may not agree entirely with the means by which the paper we are discussing suggests that the results should be obtained but none of us can in any way disagree with the basic principles which are brought out in this paper and it is in this spirit that the discussion of this valuable and provocative paper has been opened.

MONS. P. KLIJNVELD (Holland) : Mr. Chairman, my Lord President, ladies and gentlemen, before submitting my remarks on the subject of holding and subsidiary companies I would like to say that I have read the paper with extraordinary interest and I am grateful that this subject, which also interests we Dutchmen so much, has been treated so fully and efficiently. In fact my observations are intended more as a commentary to a few questions which I hope that Sir Albert, who has proved that he commands the subject, will answer.

Excepting with respect to life insurance companies there are in Holland up to this moment no legal regulations with regard to the composition of the profit and loss account, and the law only gives a few rules as to the publication of balance sheets, stating how the assets should there be mentioned and also that the balance sheet must be accompanied by an explanatory memorandum, signed by the management and directors, stating on what basis the assets are valued. One of the stipulations is that participations in other companies shall be separately in one item mentioned in the balance sheet, in combination with the advances to these participations ; the Dutch law, however, does not know a regulation such as that of the English Companies Act of 1929 with regard to the profits and losses of subsidiary companies, as Sir Albert has mentioned.

Sir Albert considers the facts and figures required by English law inadequate to afford the shareholders the information necessary to furnish them a correct view of the earning capacities of the whole undertaking, as no specification need be given, and he further observes that the regulations have the unintended effect that the Board of Directors can have a complete view of the situation, seeing that they can demand to be shown detailed figures. The regulations which Sir Albert would like to see extended may represent a great advantage for the shareholders as

compared with the countries in which there are no legal regulations with regard to the publication of profits and losses. If, however, a holding company were to go too far in their specifications of profit and losses there would be a danger that it would thereby inform the competitors, probably to the detriment of the concern. In my opinion, losses suffered by a subsidiary company should be expressed in the holding company by discounting the loss in the valuation of their interests, or, if the holding company can no longer do this in the valuation of its share holdings, to write them off from the claims which the holding company has upon the subsidiary company. I am of opinion that one cannot go so far as to state in the profit and loss account of the holding company the exact amounts with the names of the subsidiary companies.

I would therefore like to ask Sir Albert whether he does not consider it sufficient, if guarantees are offered, if the English auditor submitting a full statement should be compelled, if the company has not taken sufficiently into account the losses in participations, to make a statement to that effect. In Holland the mere signature of the auditor under the balance sheet and profit and loss account means that he assumes the full responsibility for the document signed, and it would also mean that sufficient provision has been made for losses. It will not be possible to affix such a signature for a holding company under the principles which now exist in Holland unless one has carried out the auditing of all the subsidiary companies. The Dutch auditor would in such a case make a statement in which he would place this on record, if the losses in subsidiary companies have not been sufficiently taken into account.

I should also like to ask whether there is not, when giving the matter so much publicity, a danger that one should encourage the holding companies who have made earnings themselves or from other subsidiary companies to transfer amounts to the subsidiary company showing a loss before the balance sheet is made up, so that losses are camouflaged. A far greater guarantee, therefore, would lie in a special regulation with regard to the auditors' statement for holding companies by insisting that the auditor should not only make a statement relating to the balance sheet and profit and loss account of the holding company, but also with regard to the consolidated balance sheet of the group and the combined profit and loss account.

I hope that this or the following Congress will reach agreement to fix an international certificate and an international programme of labour for accountants.

Regarding the chapter of "Definition of a Holding Company" in Sir Albert's paper I would only ask: Is there not a danger, if a holding company is not only interested in other companies having the same or an allied object but has also a preponderating interest in a bank, or if one of the subsidiary companies practically governs the administration of the fortune of the leader of the organisation? This should be reported internationally, as such a position forms a great danger. I should like to have the speaker's view on this point.

We need only glance at the events of the last few years to appreciate what a gigantic risk can lurk in the combination of an industrial operating company and a bank. Would not a great deal be attained if an international regulation could be made with regard to this? Present economic difficulties have led great concerns to expand their interests in foreign countries in order to face international difficulties, so that the institution of a holding company and subsidiary companies will, in my opinion, be considerably extended in the future. If anywhere there is here a great need for international laws and the co-operation of accountants.

In his paper Sir Albert further states that the auditor of the holding company should in fact be the auditor of all the subsidiary companies, and I agree with this, but this is not always possible in practice. There must, however, be contact between the various auditors of the subsidiary companies and those of the holding company by means of the fact that the auditors of the subsidiary companies should carry out their work according to a uniform programme or plan approved by the auditor of the holding company and that the auditors of the subsidiaries should send in their reports to the auditor of the holding company, in which reports the points which the auditor of the holding company has asked for should in any case be explained. The balance sheet and profit and loss account of the holding and subsidiaries should be submitted in a uniform manner. Particular attention should in doing so be paid to:

- (1) The valuation of the finished stocks and raw materials.
- (2) The distribution and solvency of the debtors.
- (3) The extension in the fixed assets and the depreciation written off from these, so that the auditor of the holding company can include positive statements about these in his report, naturally making the reservation that all the subsidiaries have not been audited by him personally.

An essential point is, in my opinion, that the fiscal year or periods of the

holding and the subsidiaries should close on the same date. In certain holding companies there is, besides the public auditor who audits the books at the request of the directors or shareholders, the company's own staff of auditors, who verify a part of the subsidiary companies.

With respect to the value of the reports of this audit department for the auditor of the holding company, the same views apply, in my opinion, as to the reports of the public auditors of the other subsidiary companies, namely, the auditor of the holding company will have to approve the programme or plan of the operations of the audit department and must have the right to supplement this programme if necessary, and further, that all reports, prepared as just described with respect to those of the public auditor, will have to be sent to him. He will also have to see that the verification is carried out according to instructions, and convince himself of this by unannounced inspections at variable times.

THE CHAIRMAN : We have a long list of speakers this afternoon, and for that reason, much to our regret, we shall have to limit the time of all the speakers. As they come up in turn they will find certain lights on the desk. As long as the green light is on there need be no apprehension ; then we have a warning in the form of a red light. The red light seems to have worked pretty well. (Laughter.)

MR. L. W. FARROW, F.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, may I first be allowed to congratulate Sir Albert Wyon on the exhaustive manner in which he has dealt with the subject matter of his lecture. So well has Sir Albert Wyon in his lecture covered the points which fall within the scope of his subject that there seems to me very little else to be said. Bearing this in mind, perhaps I may be forgiven if my remarks go somewhat outside the scope of the subject. My excuse is that even accounting principles may at times be influenced by public opinion, whether that opinion be enlightened or otherwise.

As Sir Albert Wyon has stated, public interest in the subject of his lecture has increased materially during the last few years. This must necessarily be so as the structures of our large industrial combines have been built up on the basis of holding and subsidiary companies. Personally I do not consider that this tendency has been a matter of intention, but rather that the rationalisation of industries, and the combination of several small units into large units has led through one cause or another to the retention of the individual companies comprising those combines. In my opinion holding and subsidiary companies have become

a permanent feature of industrial finance in this and other countries, and it is therefore of paramount importance that everything should be done that is possible to allay the suspicions which now exist and to avoid a repetition of those black spots which exist in what is the short history of this method of company finance.

If the accounting principles which Sir Albert Wyon has indicated are followed I am certain that all will be well with the future of holding and subsidiary companies. I hope therefore that the greatest possible publicity will be given to his lecture.

There are one or two points in the lecture upon which I should like to offer comments. I agree with Sir Albert Wyon that the only satisfactory method of dealing with profits of subsidiary companies, especially those which are wholly owned, is to bring in to the profits of the holding company the whole of the profits earned by the group. In other words, to treat the subsidiary companies as though they were branches of the holding company. Should there be debenture holdings or share holdings in a subsidiary company not held by the parent company, the question arises as to whether part of the profits earned, especially in good years, should be retained in that subsidiary company to strengthen its resources. If this be decided upon I still consider that the amount so retained should be brought into the profits of the holding company, but of course they must be earmarked, as Sir Albert Wyon has suggested, as not available for dividend to the shareholders of the holding company until they are actually declared by way of dividend by the subsidiary company.

As to the manner of carrying out this latter procedure there are several methods, perhaps all equally good. Personally I prefer that such profits should be held in suspense on the liabilities side of the balance sheet and added as a separate item to the value of the holding on the assets side of the balance sheet. So far as the profit and loss account is concerned, the whole of the profits earned by the subsidiary would be included with the profits of other subsidiaries, if any, and the amount held in suspense would be debited on the other side of the profit and loss account as a transfer to the suspense account, to which I have referred.

When we come to the question of losses, I think it essential that the holding company should either provide for losses made in subsidiary companies by deducting such losses from the earnings of other subsidiary companies in the profit and loss account and deducting a similar reserve from the value of the shares in the subsidiary companies or by passing credit notes to the subsidiary companies equal to the losses sustained.

Sir Albert Wyon has mentioned the question of dealing with profits on goods sold to a holding company by a subsidiary company, or what might equally apply, where profits are made on goods sold by the holding company to the subsidiary company, and I do not think that anyone can disagree with what Sir Albert Wyon has suggested should be done in relation to this matter. A difficulty however does frequently arise in this connection. A holding company may acquire another company which previously has been its customer. In the balance sheet of the newly owned subsidiary will frequently be found stocks of goods which have been manufactured by the holding company valued at the cost price to the subsidiary company. Such cost price will of course include the profit earned by the holding company on the manufacture. I suggest that it would be unreasonable to expect those stocks to be immediately written down to the cost of manufacture to the holding company or for the holding company immediately to make a reserve equal to the profit made on the manufacture of such goods. In cases such as this I suggest the correct procedure is to reserve in the accounts of the holding company profits on future sales which have the effect of increasing the stocks held by the subsidiary company.

As Sir Albert Wyon has indicated, one of the most difficult questions which accountants have to deal with in auditing the accounts of holding companies is in regard to the valuation of holdings in subsidiary companies in the balance sheet of the holding company. I have come across cases where directors have hesitated to rationalise their own group of subsidiary companies because of the effect which such rationalisation may have on the values of the holdings in the individual subsidiary companies. What I mean is this, a holding company may own several subsidiary companies all making perhaps moderate profits, but whose plants are not fully occupied. By transferring the output from one or more subsidiary companies to the rest of the group and closing down the plants of such companies materially increased profits may result to the group. The question at once arises however as to the values of the holdings in those companies whose plants have been closed down. My own personal opinion is that if the total value of the subsidiary companies before the transfer be a fair one, then I think the directors of the holding company are justified in writing down the holdings of the subsidiary companies whose plants have closed, to the scrap value of the plants, and adding the differences to the values of the remaining subsidiary companies.

Another problem which presents some difficulty is the question of the

values of the shareholdings of subsidiary companies which are making losses. If those companies were in fact not separate legal entities, but were branches of the holding company, I suggest that the auditors would not comment on the value of the fixed assets. In view of the fact however that the net assets of these companies are included as an investment in the balance sheet of the holding company, the minds of the auditors immediately become agitated. In point of fact the position of the latter case might be more favourable to the holding company than that of the former, as it may be an easy matter to jettison a subsidiary company, whereas it may be an extremely difficult matter to get rid of fixed assets owned directly by the holding company which may be a source of considerable expense. Of course, if either of these events happen, if the values are not written off, the auditors will be compelled to comment on the matter in their report.

I agree with what Sir Albert Wyon says on this matter however, and there is no question that the investing public and the financial press view the values of shares in subsidiary companies differently from the values of fixed assets in the holding company, and I suggest the professional accountant cannot afford to overlook the distinction.

There is one suggestion which Sir Albert Wyon makes with which I am unable to agree.

I refer to his suggestion that it is advisable that the same auditors should be employed to audit the accounts of all companies within a group. If his alternative suggestion be acted upon, and I heartily agree with that suggestion, namely that the auditors of the holding company should have access to the detailed accounts of the subsidiary companies and should be empowered to call for full explanations from the directors and auditors of those companies of any matters in the accounts which they consider may require explanation, I suggest the fullest protection is given not only to the auditors of the holding company, but to the investing public.

MR. C. E. FLETCHER, F.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, you will all agree that Sir Albert Wyon's paper is of great interest to us, and I am sure that you also agree with the basic soundness of the views set out therein. The paper is of particular interest to me and I should like to add a few words of comment on some aspects of the problems that have to be dealt with in connection with the accounts of the holding companies, but I wish it to be clearly understood that any views I may express are personal.

Sir Albert Wyon mentioned in the early part of his paper that legislative attempts to deal with the subject of holding companies and their accounts have been few and ineffective, and this I should like to endorse heartily.

We have now had the 1929 Companies Act with us for some four years. When this Act was being considered a Committee, consisting of a number of very eminent men sat for a long time and heard evidence from a large number of the leaders in the profession and in industry, and as a result of their deliberations the 1929 Act was produced. A portion of the deliberations dealt with the question of holding companies and certain attempts were made in the Act to insert provisions, presumably intended to protect the holders of shares in holding companies from the designs of directors whom either from a desire for excessive secrecy or for some other or less pleasant motive, were desirous of telling shareholders as little about their property as possible.

While I do not think that the Act has not had some good effect, I feel that it has not been of the benefit to shareholders which it was hoped it would be, and I do feel very strongly that no amount of legislation, however cunningly devised, will ever be able to prescribe such laws for the drawing up of accounts as cannot be, to some extent, got round or evaded, when one comes to consider the vast number of different forms of undertakings to which accounts must apply and the impossibility of laying down a statutory form which will suit all types of business.

As far as legislation touching accounts is concerned, there will always be in the world a certain number of individuals desirous of publishing accounts which do not reflect the true position, but because there are a few such individuals, it does not seem reasonable that honest traders should be hampered by legislation devised to defeat the wiles of a few dishonest individuals. The problem is one of common sense and it seems to me obvious that if an auditor feels that a balance sheet, whether that of a holding company or any other company, does not give reasonable disclosure to the shareholders, it is his duty to amplify his report in such a way as to bring to the notice of the shareholders the information not disclosed by the accounts.

I am in entire agreement with Sir Albert Wyon's remarks dealing with the statement to be given by directors under Section 126 of the 1929 Act to the effect that the particulars required are of so general and so vague a character as to be quite insufficient to supply shareholders with the necessary information. It seems to me that in a case where a holding

company brings to the credit of its profit and loss account the profits of its subsidiary companies, and provides for the losses, that a statement to that effect is sufficient, as the profit and loss account will then reflect correctly the results of the trading of the group as a whole, but in cases where subsidiary companies make large profits which are not brought in but which are left as reserves in those companies or as undistributed profits, I think that further disclosure is required. •

I do not suggest it is necessarily wrong for holding companies to accumulate profits in their subsidiaries, although it is a practice which I have found to cause a certain amount of trouble in individual cases.

While on the subject of Section 126, I would like to mention the clause which requires that qualifications appearing in the accounts of subsidiaries should be shown in the statement to be annexed to the balance sheet. In my experience, this clause has little or no effect, and if there appear in the accounts of subsidiary companies qualifications which affect the position of the holding company in respect of which provision is not made in the holding company's accounts, it is surely the duty of the auditor to bring such a statement to the notice of the shareholders. Provided that the accounts of the holding company are so drawn as to show the position of the group as a whole correctly and provision is made in those accounts for any items which may have been omitted in the subsidiary company's accounts, it is misleading in my opinion for the directors to be obliged to quote a number of qualifications in the auditors' reports of subsidiary companies which have been rectified in the parent company's accounts.

While on the subject of qualifications, although the word qualification is used in the 1929 Act, no definition of what it is intended to cover is given and therefore it would appear that directors are entitled to decide for themselves what exceptional wording in an auditor's report constitutes a qualification.

A subsidiary company is defined in the 1929 Act, speaking broadly, as being one in which the holding company holds more than half the shares, but it is quite common to find amongst the assets of holding companies substantial shareholdings in what may be described as allied companies of 50 per cent. and under, the holding company being virtually a limited partner in these concerns.

I have heard of cases where directors have suggested that because such companies are not technically subsidiary companies it is not necessary for them to take into account their share of the profits and losses, particu-

larly the losses, in arriving at the results of the holding company but this seems to me to be quite an untenable point of view if a holding company invests large sums of money in what are virtually partnerships and prepares accounts which do not provide for their proportion of the losses.

Sir Albert, in his remarks on the valuation of holdings, has made some very pertinent observations which I thoroughly endorse; particularly would I refer to his mention of the importance of realising how misconceived is the notion that the balance sheet of a commercial undertaking purports to set forth the value of the assets. Holdings in subsidiary companies are, in my view, fixed assets, and should be valued for balance-sheet purposes accordingly. When a holding company acquires an interest in a subsidiary company, in effect it invests a certain proportion of its capital in that particular company because it hopes by so doing it will be able to earn satisfactory profits. If, however, the hopes of the directors are not realised and losses occur, apart from special circumstances, all the directors can be asked to do is to provide for those losses—in other words, to maintain intact the capital which they have sunk in the subsidiary company. I think that a good reason for this view can be given in this way. Supposing that a company owns a number of works. Provided that the company provides the usual depreciation upon these undoubtedly fixed assets, I do not think it is an auditor's duty, unless there are any very special reasons, to endeavour to form an opinion as to the break-up value of the bricks, mortar and plant. Supposing, however, the company decides, for reasons of policy, to transfer one or more of its works to a subsidiary company and the business is, in effect, carried on in exactly the same way as it was previously carried on, can it be suggested that merely because the subsidiary does not earn considerable profits that the question of the value of the shares in that company should be considered say, on an earning power basis merely because the company has transferred part of its fixed assets to the subsidiary? I am strongly of the opinion that shares in subsidiary companies are just as much fixed assets as land, buildings, plant and machinery, and I cannot conceive, if this opinion is wrong, what an auditor's position is with regard to subsidiary companies. I am only stating this as a general principle, as of course special circumstances may arise when it is necessary to consider the value of holdings in subsidiary companies, but in the ordinary course of events, provided that the holding company maintained its capital in the subsidiaries intact, and shows how it deals with their profits and losses,

directors or auditors cannot be expected to go into the question of values either for purposes of sale or from an earning capacity point of view.

With regard to the treatment of the earnings of subsidiary companies, I think there is apparently some divergence of views as to the best ways of treating them. Some hold that profits should not be brought in until declaration as a dividend and others hold that a more accurate picture is shown in the balance sheet if all profits and losses are brought into account. Personally, I am of the opinion that the most accurate picture is presented where all profits and losses are brought in, provided always it is clearly shown on the face of the accounts that the accounts have been drawn up on this principle and it is shown that the accounts contain the profits of separate legal entities, which, not having been paid over as dividends, have not become legally the property of the holding company. If only dividends from subsidiaries are brought in, these in the ordinary way will not be the same figure as the actual profits, consequently an inaccurate picture is presented of the earnings of the holding company and its subsidiaries.

The principle of including in the profit and loss account all profits and losses of subsidiaries has another great virtue to my way of thinking, that is, it precludes directors from hoarding up profits from subsidiaries in good years and bringing them to the credit of profit and loss account in the lean years without wishing to disclose the position to their shareholders. I think that in cases where dividends from subsidiary companies include profits accumulated in previous years that this position must be disclosed to the shareholders.

I quite agree with Sir Albert Wyon's suggestion that the ideal method of dealing with the profits of holding and subsidiary companies is to declare them as dividend up to the hilt and include such dividend in the accounts, but I have found, in practice, that this is not always practicable as subsidiary companies may be located all over the globe and although it may be possible to ascertain their results, it may not be possible to obtain a declaration of dividends in time for inclusion in the accounts of the parent company, but whichever way individual companies may elect to deal with their subsidiary companies' results, the results which they incorporate in the accounts of the holding company should be approximately the true results of the year, and not either a substantially greater or lesser figure.

In conclusion, I should like to endorse, with all the powers at my command, Sir Albert Wyon's statement that neither directors nor auditors

should be satisfied with bare compliance with statutes. So far as an auditor's position is concerned, audit is a question largely of common sense and if an auditor considers that a balance sheet submitted to him for his report does not give such information as he thinks the shareholders should have, and it does not present a true picture, the compliance with all the statutes in the world will not excuse him from the necessity of referring to the position.

MR. RICHARD A. WITTY, F.S.A.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, as a motorist, I absolutely hate the sight of a red light, and quite apart from that fact I feel sure that the members of this Congress will forgive me if I confine my remarks to three or four minutes at the outside. They will forgive me if I deliberately forget all the mental notes I made with regard to the many details in Sir Albert Wyon's paper. I therefore propose just to deal in a very few sentences with two broad principles which were enunciated by Sir Albert Wyon. I want, in the first place, to emphasise and heartily to endorse the contention of Sir Albert that insufficient stress has been laid on profit and loss accounts and that hitherto too large a share of public attention has been bestowed on statements of assets and liabilities, because I think it can be said that every argument used by Sir Albert points to the necessity of our reviewing our ideas as to the relative importance of balance sheets and of profit and loss accounts. That applies very particularly and is emphasised very specially in the case of profit and loss accounts of holding companies. But Sir Albert Wyon did not feel at liberty to discuss that point at length, having regard to the specific title of his paper, and I must follow his example in that respect. The other broad contention that I would like to deal with is his concluding remark that the solution of these problems is not to be found in legislation, but rather in the spirit in which directors of companies and auditors approach these problems. Of course, we all know that it is impossible to protect the fool against his own folly but, as is mentioned in one of the articles in the copy of *The Accountant* which was given to every member of this Congress, the Macmillan Committee specially said that the mere fact that you cannot protect a fool from his own folly is no reason why you should not give the prudent man guidance. That, it seems to me, is surely exactly what Sir Albert Wyon has been doing in this paper, and if he can succeed in persuading the practising accountants of this country to approach these problems in this spirit then I think he will have earned the gratitude of every reasonable shareholder, and I think, perhaps, we

might even go further and say that if all practising accountants would follow that principle and would remember the phrase "giving the fruit for man's guidance," it would be accepted as a far better epitome of the general duties of auditors, shall we say, than all the watchdogs and bloodhounds that ever stalked through the pages of a textbook. (Laughter and applause.)

THE CHAIRMAN : Mr. Witty beat the red light. (Renewed laughter.)

MONS. M. PIMENTEL (Holland) : Mr. Chairman, my Lord President, ladies and gentlemen, I have read with great interest the paper by Sir Albert Wyon in which he briefly but drastically deals with "The Accounting Principles involved in the Treatment of Earnings and Valuation of Holdings."

Before passing to the subject itself I cannot refrain from seconding what Sir Albert has said with regard to the late Sir Gilbert Garnsey. To us Dutch accountants he was a well-known figure. His book "Holding Companies and their Published Accounts" is greatly used in our country and is often quoted in other works on this subject.

In studying the paper I was first of all struck by Sir Albert's observation that he thought it was permissible in English law for a subsidiary company to declare dividends out of profits made after its shares had been acquired by the holding company, without reference to pre-acquisition losses. I am not sufficiently acquainted with the British law to be able to form my own opinion of this, but I am sure that such a procedure would be in conflict with Dutch law. According to our company law a dividend may, generally speaking, only be declared after previous losses have been wiped off, either out of the capital or out of the subsequent profits of the subsidiary. As a rule, the latter method is preferred, because the former has drawbacks of a fiscal nature.

It is not quite clear to me what Sir Albert means with regard to the payment of dividends by the subsidiary company, where he points out that it is desirable for the subsidiary company which is financed by the holding company to pay the dividend by cheque or warrant on its bankers and that the depleted funds of the subsidiary should be supplemented by the holding company. I fail to see the necessity of settling in this way. In my opinion it is advisable that when the holding company finance the subsidiary and the two companies consequently have current accounts with each other, either directly or indirectly via other subsidiaries, to stipulate that as soon as the subsidiary has a balance in hand this should be remitted to the holding company, whilst the payment of divi-

dend can be settled in current account, assuming, of course, that the holding company holds all the shares of the subsidiary.

The foregoing refers in the main to the payment of the profits made by the subsidiaries. I will now make a few remarks as to how these profits are determined.

In the example given by Sir Albert on page 132 of his paper with regard to amortisation of leaseholds I observe that the subsidiary would have to compute the provision for amortisation on a basis of £100,000—whilst the holding company would have to make such a provision that the total allowance for depreciation would be based on £300,000—that is the price paid by the holding company for the shares.

I fail to see the necessity of such a policy. In my opinion there would be sufficient guarantees of good management if the subsidiary wrote off nothing at all, or, as I should deem preferable, to base the allowance for depreciation on the whole amount, namely, £300,000. In fact, only in the latter case does the profit and loss account of the subsidiary give a true representation of the state of its affairs. It goes without saying that the holding company in valuing its interest in the subsidiary must take into account the policy of writing off adopted by the subsidiary, and, in valuing its shareholding or the other assets which constitute these interests, in the subsidiary, must value these assets in such a way that the total allowance for depreciation is based on £300,000. Then the profit and loss account of the holding company will likewise give a true representation of the state of its affairs.

And now, with regard to the section "Earnings," I should like to say a few words concerning foreign subsidiaries. Sir Albert has rightly pointed out that owing to the monetary difficulties in the various countries it is advisable that the holding company pay no dividend from the dividends of subsidiaries abroad which have not been received. But even when these dividends *have* been received the greatest prudence must under the present circumstances nevertheless be exercised by the holding company in declaring its dividend.

Many subsidiary companies will in a large number of cases make reasonable profit, which will result in a dividend being paid to the holding company. However, when the financial position of such a subsidiary is examined it may be found that the profit has really, wholly or partially come about through the depreciation of the currency in the respective country and that the working results of the subsidiary would actually show a loss.

It goes without saying that in this case no dividend may be paid, as the payment of dividend would be a draw on the holding company's own capital, by which I do not mean the nominal amount on the company's books, but the amount needed to enable the concern to maintain its position in society. Not only may there be no dividend declared but the so-called profit or dividend of the subsidiary may not appear as a profit in the books of the holding company. It will even be necessary to make provision for the depreciation of the value of the interests of the holding company in the subsidiary.

On the other hand, there is a possibility of the currency of the holding company's country depreciating and that of the subsidiary's country remaining normal. In this case when the balance sheet of the holding company is being made up difficulties will arise, especially as regards the determining of the trading profits of the subsidiaries.

I regret that the time allotted to me does not permit of my going into details. I trust, however, that I have succeeded in pointing out the problems with which the subject is attended.

And now, with regard to the question of valuation I would observe that although Sir Albert has given many definitions of the notion "Value" he has made no mention of the new theory referred to as "Replacement Value," which forms the basis of the doctrine of "The Organic Balance Sheet," about which, especially in Germany, so much has been written.

Once again public interest is focused on the notion "Replacement Value," particularly in connection with the difficulties of a monetary nature, for example inflation, and rightly so, seeing that one of the first requirements of good management is maintaining the concern in the position it has so far occupied in society.

In conclusion, Sir Albert has gone so far as to discuss the form of accounts and the audit of same. I would, therefore, also beg leave to speak a few words on this subject. With regard to the form of accounts I share Sir Albert's views, that with a combined statement of affairs the real third-party interests in the holding company are made vague. This objection is, however, removed by compiling a combined balance sheet for the subsidiaries and a separate one for the holding company. With regard to auditing, I beg to differ from Sir Albert in respect of those subsidiaries' accounts which are not audited by the accountant of the holding company. In my opinion, the accountant will have to depend on the reports published by the auditors of the subsidiaries, providing,

of course, such accountants are of good repute. Moreover it will often occur that the holding company has an audit department. In this case the accountant who has to certify the balance sheet and profit and loss account of the holding company may likewise depend on the reports issued by this Audit Department, assuming that : (1) This Department is directed by reputable accountants. (2) The scheme of auditing is made out in consultation with and with the approval of the Public Accountant. (3) All questions of any importance are discussed with him and in which questions his word is binding. (4) The Public Accountant adopts such measures that the principal items of the administration are checked by him and/or his assistants. (5) Last, but not least, the administration is well managed and there is adequate internal check.

I would close my observations with a word in praise of Sir Albert and appreciation of his most interesting address. Thank you.

SIR BASIL E. MAYHEW, K.B.E., F.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, I desire to express my thanks to Sir Albert Wyon for his admirable contribution to a subject which is of such great interest to accountants. I would like, at the outset, to associate myself with the remarks which Sir Albert Wyon made at the commencement of his paper about the late Sir Gilbert Garnsey. The accountancy profession suffered irreparable loss through his death at so early an age. None was more competent than he to deal with this particular subject.

It is naturally impossible to discuss every difficulty arising on the accounts of holding and subsidiary companies in an address of this character, but Sir Albert has touched upon many of the more important points.

The problems presented by the accounts of holding and subsidiary companies are not peculiar to any one country, and difficulties of a similar character are experienced by accountants throughout the world. I think the views expressed by Sir Albert Wyon fairly represent the general opinion of the profession in the British Isles, but whether we agree with them or not I know that his concluding remarks will be endorsed by every qualified accountant.

Early in his paper, Sir Albert dealt with the question of profits of subsidiary companies and mentioned that it is the practice of some holding companies to take up in their accounts the entire profits of their subsidiaries, whether declared in dividend or not. I think there is no doubt that it can be done. There is, however, no uniformity on this point

and opinion amongst accountants in this country is by no means unanimous. It is, of course, true that the profits of a subsidiary company do not become a legal debt to the parent company until declared as dividends. Two points must be emphasised when this procedure is followed. Firstly, it must be remembered that the holding company must not itself declare a dividend out of such profits until they have been declared as dividends by the subsidiary company. Secondly, the method of describing in the balance sheet the profits not yet declared as dividends must be carefully considered. If, between the date of the balance sheet and the issue of the accounts, the dividend is declared by the subsidiary, then I am of the opinion that the asset may be treated as a current asset. On the other hand, where it is known that such profits, or part of such profits, cannot or will not be declared in the form of dividends, most careful consideration must be given to the manner in which this asset is dealt with in the balance sheet.

Another question which may arise in connection with this method of treating profits of subsidiary companies is the correct amount to be brought into the holding company's profit and loss account where a subsidiary has allocated a proportion of its profits for the year to a free reserve. It appears to me to be defensible for the holding company to credit the full amount of the profits before the transfer to reserve, provided that it is made perfectly clear by wording in the profit and loss account and balance sheet of the holding company what has been done. To do otherwise would be to defeat what Sir Albert has described as "the merit of showing clearly the aggregate of the profits earned by the organisation during the period." I am a strong supporter of the policy of publishing a consolidated balance sheet and profit and loss account of the group, although I realise the practical difficulties in a great number of cases.

Where the whole of the profits are not brought in by the holding company the considerations mentioned by Sir Albert are of extreme importance. The Board of a holding company may decide that it is desirable that the earnings should show a controlled steadiness from year to year, and, to attain this end, keep something in reserve in the subsidiaries. Whilst this course may be highly commendable it would in my view be misleading if undistributed profits of previous years were used to make up profits of later years without the fact being disclosed.

I should like to say a few words here in connection with foreign subsidiary companies. An accountant with a knowledge of the laws in force

in the country in which the foreign subsidiary is situated, or having a ready means of acquiring such knowledge, can be of the greatest assistance and in this connection an International Congress such as this enables us not only to make new friends but to meet face to face accountants from all parts of the world with whom one day we may have business relations. It may be necessary to weigh carefully the advantages and disadvantages between exercising effective control by the holding company and allowing the subsidiary complete and independent control. If profits are allowed to accumulate abroad, it must be borne in mind that there is a risk of a loss of exchange, that currency restrictions in force may prevent the transfer of such profits, that there may be a capital, a profits, and a dividend tax to be paid abroad, so that the eventual sum received by the holding company may possibly be considerably less than the figure shown by the subsidiary's accounts. In this country if effectual control is found to be exercised from the British Isles, British income-tax becomes payable on the full adjusted profits on foreign subsidiaries, whether remitted to this country or not, in addition to any taxes payable in the country where the company is situated.

Sir Albert raised an interesting point when he said that provision should be made for a loss made by a subsidiary in the period intervening between the date of the accounts of a subsidiary and the accounts of the holding company. The Companies Act in force in our own country does not require such provision to be made, and although prudent directors would do so, it appears that, as the law stands at present, they could not be held responsible for failing to provide against a loss of this description. The law requires that there should be a statement signed by the directors annexed to the balance sheet of the holding company stating how the profits and losses of the subsidiary company have, so far as they concern the holding company, been dealt with in that company's accounts, and counsel has advised that the profits or losses referred to in this particular section mean the profits or losses shown in the accounts of a subsidiary for the period covered by the last account available. It is therefore possible for a subsidiary to prepare its accounts at a date eleven months prior to the date of the holding company's accounts and still to remain within the letter of the law.

Turning for one moment to the audit of the accounts of these holding companies, I would stress the necessity of an auditor devoting the most careful consideration to the wording on a set of published accounts. The auditor may exercise his mind for many weeks in satisfying himself that

the figures in the profit and loss account and balance sheet are correct, and yet fail in his duty if certifying that the balance sheet shows a true and correct position through allowing the use of the wrong, or inadequate words.

Standardisation of the form of accounts would indeed seem desirable, but at present appears to be impracticable. I believe you know that this question was considered by the American Institute of Accountants when they recently submitted a memorandum to the Federal Reserve of Washington, and they also came to the conclusion that corporations should be free to choose, within very broad limits, their own method of accounting, provided that the method adopted is followed consistently from year to year. They stated in their report that "it is probably fairly well recognised by intelligent investors to-day that the earning capacity is a fact of crucial importance in the valuation of an industrial enterprise and that therefore the income account is usually far more important than the balance sheet. In point of fact, the changes in the balance sheets from year to year are usually more significant than the balance sheets themselves."

I think it is a pity that fuller information is not given in published profit and loss accounts. I am not greatly impressed with the argument which is so frequently put forward that it is giving information to competitors.

In connection with loans and advances to subsidiary companies, I consider any amount of such loans as have been used by the subsidiary in the purchase of a fixed asset, and which are unlikely to be repaid, at least in the near future, should be so described on the balance sheet of the holding company. Where such loans carry interest and the interest-charge is capitalised in the accounts of the subsidiary careful consideration should be given to the question of whether the interest may be taken to the profit and loss account of the holding company.

We have heard that the commercial community, and possibly the law in this country, regard an under-statement in profits with a leniency which is not extended to an over-statement. I suggest that similar considerations apply to the figures at which assets, including shares in, and loans to, subsidiary companies, are shown. Nevertheless, in the well-known case of one of our largest industrial concerns, the auditor, Lord Plender, qualifies his report with the remark that "the investments in subsidiary and associated companies possess, in the aggregate, a value largely in excess of the figures shown in the balance sheet." Here, indeed,

is an instance of the auditor (at least) not slavishly following precedent.

The President of the United States has seen fit to devote a chapter of a recent publication of his to the question of holding companies, which suggests that the days of reform may not be long postponed in the U.S.A., and I foresee changes in the laws of other countries with regard to these companies, whilst it is well-known that there is a certain amount of dissatisfaction in our own country with the law as it stands at present.

I have left untouched many points which I should like to have dealt with, including the treatment by a holding company of a dividend from a subsidiary where such subsidiary itself holds shares in the holding company. I have, I am afraid, already transgressed far beyond my time and I would like to close by again assuring Sir Albert that his paper will be of much help to the profession.

MR. THOMAS KEENS, F.S.A.A. (Great Britain) : My Lord President, Mr. Chairman, ladies and gentlemen, sitting in this room to-day one has had an experience, which is not uncommon, of finding the points that one wanted to make taken up and most adequately expressed by previous speakers. Therefore I will not attempt to go into any detail but will confine myself to one or two points.

We all know the unique position which the author of this paper occupies in the Accountancy world, and I am perfectly certain that there is no one in this room who would not desire to associate himself with the remarks in the paper, and the remarks of Sir Basil Mayhew, with respect to Sir Gilbert Garnsey. (Hear, hear.) With regard to the importance of the subject, we all agree that it cannot be over-estimated, and the difficulties are best expressed in the words of Sir Albert—"the attempts of legislatures to deal with the subject have been few and ineffective." The urgency of the question is shown by the feeling of uneasiness and suspicion disclosed by the national press and the statements of those whom we properly regard as leaders of the Accountancy Profession. This is, of course, not remarkable, in view of the situation described by Sir Albert. The provisions "(of the Act)" may "indeed have the unintended effect of providing justification for directors who wish so to prepare the accounts of a holding company as to conceal from those chiefly interested the actual results of its activities." I am, of course, quoting. As to the definition of "holding company," on page 124, that suggested by Sir Albert seems to be so good that in any amending legislation I trust that the Parliamentary draughtsman will incorporate it. Having regard to previous experience it is probably too much to hope, because clarity of

expression is apparently about the last thing he aims at. (Laughter.) There is, of course, a certain amount of overlapping and Mr. Witty dealt with the point of the profit and loss account which I was going to emphasise. With regard to the conclusions of the paper, I desire to call attention to two points only. The first is the general question as affecting all companies having subsidiaries and sub-subsidiaries. I suppose there are a good many in this room who are qualified to speak on this question from two points of view—one, as practising accountants with experience and the other, as financial directors of industrial companies having subsidiaries and sub-subsidiaries. Sir Albert remarks on page 128 that the most correct accounting treatment is to bring in all earnings as if it were one company. That has had a good deal of support to-day. But again on page 128 he remarks that this results in the inclusion of profits of subsidiaries which have not been, and may never be, distributed. Again he says, and properly, "Under British law . . . the profits of a subsidiary company do not become the property of the holding company except in so far as those profits are properly declared as dividend." This is undoubtedly so, and I submit that anything more in the profit and loss account raises a partly artificial state of affairs and leads to a number of conclusions which, to my mind, are unsatisfactory. It is surely the practice in well-managed industrial undertakings that the financial policy should be to build up adequate financial reserves for extending the business without recourse to more than temporary borrowing, and that the policy of the subsidiaries should be on the same lines. This policy is obviously impossible if the lines indicated on page 129 are followed by the declaration by the subsidiary company of the whole of its profits as dividends and loans are made to the subsidiary companies if necessary to enable them to do this.

There appears to me to be another objection, and that is that the balance of profit on the balance sheet differs materially from that available for dividend, and we have an artificial transaction to give effect to it.

There is another point. I cannot develop the argument—I ought, perhaps, to have done so, having regard to the speakers who have gone before me—Sir Albert suggests that the audit of all subsidiaries should be in the same hands as that of the holding company. We know very well that in recent happenings a good deal of things which are utterly wrong might have been prevented had it been possible to have got the whole of the accountants together and to see where the leakages really were. On the other hand, I would submit that with regard to the Gargantuan

undertaking with hundreds of subsidiaries the fact remains that if there were one auditor the amount of devolution that would have to take place by him would be so great that no particular advantage would be gained over the alternative method suggested by Sir Albert, and that is a Conference of all the auditors engaged and the results attained by each being made known to the others. If that practice were followed I submit that better results might be achieved. I would also point out that from the view of the profession, when we consider the displacement that there has been* of otherwise excellent men, against whom nothing could be urged by way of character or ability, particularly the displacement which has taken place in some parts of the country, I am unwilling to assent to any procedure which would result in still further displacement without, so far as I can see, any apparent advantage to the community.

MR. BRIAN MANNING, F.C.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, I share the diffidence of Mr. Peloubet in speaking on this paper. Plato when he was asked to speak against Socrates, said "How shall I criticise Socrates, who has taught me all that I ever knew?" That may not be true in the case of Sir Albert Wyon and myself, for he was not my tutor, but I feel the lesson that is implied. If there is any merit at all in my remarks, Mr. Chairman, it is that they will be delivered during the currency of the green light, unless you decide otherwise!

Sir Albert Wyon has spoken to us of his experience, which he tells us dates back a good many years, and in acknowledging now the great value of his paper we can pay tribute to this experience, which enables him to compare the holding and subsidiary companies of years ago with those we know to-day.

Many of the problems which subsidiary companies present to us and to the public arise largely from their abuse. During past and recent years there have been cases where serious frauds have been perpetrated through this medium. Sir Albert has implied that things are not perfect. But hard cases make bad law, and it is worth while, before throwing too much blame, in this country, on the Companies Acts, to consider whether any practical legislation can provide a complete remedy. Personally, with perhaps a little too much faith in human nature, I hold the view that public opinion and the ministrations of members of our profession can provide greater safeguards than rigid and cramping legislation, which may restrict legitimate enterprise. Sir Albert gave expression to this at the conclusion of his paper, when referring in encouraging terms to the

example of the United States and Germany, though we must remember that distance lends enchantment to the view, and it may be that if the practice in this country were examined in the same perspective it would not suffer by comparison.

Sir Albert has said so much that we must all support that we are prompted, in discussing his paper, to limit ourselves to the more contentious parts of it. Let me therefore say that I wondered, where he dealt with wholly owned subsidiaries, though in law separate entities, as being from many aspects nothing more than branches of the holding company, whether he would apply that principle whatever the relation of the activity of the subsidiary company to the holding company. So many subsidiary companies are complete entities in themselves that the holding company is little different from a body of shareholders, and present methods of accounting provide so well for the treatment of dividends of subsidiary companies that one wonders if it may in many cases be inadvisable to incorporate the profits in the accounts of the holding company, however segregated; on the other hand, the submission of a memorandum consolidated profit and loss account is always to be recommended. No one will question the importance, which has been emphasised, of ensuring that as far as possible accounts should show earning capacity and that material drafts on reserves or profits of earlier years, should, as far as possible, be particularised in the accounts of the holding company.

Sir Albert, owing to limitations of space, could not say all he would have wished, but I was hoping that he would have had the opportunity of giving his views on the treatment in the accounts of a holding company of bonus shares declared out of the profits of a subsidiary company.

Sir Albert also refers in an interesting way to the importance, which has not in the past been sufficiently stressed, of the profit and loss account, and the story it tells of earning capacity. In view of his remarks it is significant that Dr. Schacht, the President of the Reichsbank, should have said, only about a week ago, in dealing with the necessity for maintenance of earning power in Germany: "I have always been in favour of maintaining earning power rather than conserving capital. I think the essence of a business lies in the profit and loss account and not in the balance sheet. If you are making a loss whatever you do with the balance sheet will not help you." I am not sure that Sir Albert would have expressed it quite in that way, though we see what Dr. Schacht means. But for what Sir Albert *has* said, in his own way, we are grateful, and

he has turned our minds on a road which we can follow with profit.

MR. HENRY MORGAN, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, may I, first of all associate myself with the references to Sir Gilbert Garnsey ? The course of events threw me into very close touch with Sir Gilbert Garnsey, and it was my privilege on many occasions to discuss with him this knotty problem of holding and subsidiary companies. I know that his views upon the subject were identical with those which have been put forward by Sir Albert Wyon. To me it has been a very great pleasure to read Sir Albert Wyon's paper as it must also be to every student of the science of accountancy. It must be quite obvious to every accountant that if the principles put forward by Sir Albert Wyon are not given effect to in preparing the accounts of holding companies, those accounts cannot be true and correct.

Now, to my mind, three questions arise. First of all, to what extent are those principles adhered to in actual practice ? Secondly, should they be adhered to ? And thirdly, if they are not adhered to, what is the auditor's duty ? I agree entirely with the views that were expressed by Mr. Farrow. There is no doubt that in the case of holding and subsidiary companies the investing public do regard their accounts with a very great deal of suspicion. And is it to be wondered at ? I would refer you to Sir Albert Wyon's observations on page 124. " . . . the particulars required by the Act to be disclosed are of so general and vague a character as to be quite insufficient to supply shareholders with the information necessary for them." Now, we are aware that the most usual statement to comply with Section 126 of the Act, to the effect that profits of subsidiary companies have been included to the extent of dividends declared, cannot give effect to the views of most of the speakers from this table to-day. The Act requires disclosure as to how the profits of subsidiary companies have been dealt with, but in addition to the dividends declared considerable sums might have been placed to reserve ; large sums might still be carried forward in the accounts of subsidiary companies. Those dividends might to a large extent have been the result of profits earned in a year prior to that of the accounts under review. Unless there is an alteration in practice it must be quite obvious that the principles advocated by Sir Albert Wyon and assented to by speakers here to-day cannot be given effect to. I hope that the views expressed by Sir Albert Wyon and by other speakers to-day may have the result of so improving the practice in regard to the accounts of public companies that a great deal

of the suspicion which at present attaches to the accounts of those companies will be removed.

MR. W. A. STAUB, C.P.A. (United States of America) : Mr. Chairman, my Lord President, ladies and gentlemen, before I address myself to the subject of this admirable paper that has been presented to us this afternoon I should like to take the opportunity of bringing to the Congress the greetings and good wishes of the Society which I have the privilege of representing here, the New York State Society of Certified Public Accountants. As, I suppose, most of you know, owing to the fact that the United States is a Union, or Federation, of 48 separate sovereignties it was necessary for legislation recognising the profession of accountancy and creating the title and designation of Certified Public Accountant to proceed along State lines, consequently it took a period of approximately 20 years for the enactment of laws in all of those 48 States, also in the district of Columbia, to recognise the profession and to provide for the examinations which are held annually or semi-annually in the different States and the District of Columbia. Consequently each of our States and the district has a separate Society of accountants, in addition to the two national organisations, and some of them are of considerable size. Our New York Society, for instance, has several thousand members, and is approximately as large as each of our national organisations separately.

The remarks of Mr. Peloubet in opening the discussion on the subject of consolidated financial statements reminded me of the fact that in the agenda of the Congress in New York four years ago the subject of consolidated financial statements was one that received considerable attention. The British viewpoint of the subject was very ably presented by Mr. Cash, and the presentation of the American viewpoint fell to my lot. The use of consolidated statements has become very general in the United States, and I was reminded by seeing Sir Arthur Lowes Dickinson in the meeting this afternoon that approximately a generation ago, when he was in active practice in the United States, he gave considerable form and direction to our practice in the States in the preparation of consolidated statements. The use of such statements for a long time, and increasingly so over the years, displaced the use of separate statements, either balance sheets or profit and loss accounts, in the published reports of large Corporations having a considerable number of subsidiaries. Some of our public utility companies over there have several hundred subsidiaries, and that seemed the practical method of presentation, and is still so regarded. Latterly, however, it is becoming recognised that

there is a certain value in presenting, in addition to the consolidated statement, certain statements of the holding corporation, and a number of our corporations—not yet anything like a majority, or 50 per cent., or even 25 per cent.—are now in their annual reports presenting both the unconsolidated statement of the parent company and the statement on a consolidated basis. In the legislation enacted since President Roosevelt has taken up this matter of the protection of the investor, the Federal Securities Act imposes very heavy burdens and responsibilities upon the accountants in the State. I have participated with a group of accountants there in discussions with the Federal Trade Commission, which is charged with the administration of that Act, respecting regulations which are being issued; and the regulations which are in draft—they were not finished when I left the States—provide that any company issuing securities must in its application for registration thereof prepare for submission to the Commission both the unconsolidated statement of the company issuing the security and the consolidated statement of any group having subsidiaries or sub-subsidiaries or any affiliations of any other kind. The question naturally arose as to the degree of consolidation in such consolidated statements. That is always one of the problems and difficulties when we come to the question of consolidated statements, whether there are subsidiaries which are not fully covered. At first the regulations of the Federal Trade Commission required the inclusion of all subsidiaries in which there was a quantity of 50 per cent. or more. However, it was readily recognised when we got into discussion of the subject that that was not a desirable compulsory requirement, and the matter stood. Our last discussion was in the fashion of requiring that all corporations over 75 per cent. owned should be normally included, that those between 50 and 75 per cent. which were controlled in any other way or affiliated in such a way as to give control should be included, or not included, according to the circumstances, as to whether the disclosure would be informative or the reverse.

MONS. H. SÉNÉCHAL (France): Mr. Chairman, my Lord President, ladies and gentlemen, there is certainly nothing to be added from the accountancy point of view to the very clear, concise and complete paper of Sir Albert Wyon. In the name of the French Delegation I only wish to draw the attention of the Congress to a short remark and to make a suggestion. The remark is that the question of holding and subsidiary companies could be extended from the fiscal point of view. Whether one likes it or not, the intervention of the fiscal authorities of every

country cannot be avoided in relations between holding and subsidiary companies. Although these relations are various I will take one concrete case to explain as clearly as possible how the difficulties are arising. As an example, let us suppose an American factory decides to create in France a subsidiary company to sell its products. The American holding can fix the selling prices in such a manner that it will be impossible for the subsidiary company to make any profit in any way, and, of course, to pay any trading income-tax. The question is foreseen in the French law since 1872, since which time four or five other laws have been made on this subject, the most recent being in the last month of May. One of our colleagues in Paris has sent to the General Secretary of the Congress a paper defining this question from the French point of view. Briefly, in the case here above mentioned, the French fiscal authorities do not accept the profit and loss account as it appears in the books of the subsidiary company. They request the company to submit a certified balance sheet of the holding company, and the trading income is calculated in proportion to the combined results revealed by the holding company's balance sheet, generally taking into consideration the average percentage of gross or net profit on the full turnover of the company and applying this average percentage to the turnover made by the subsidiary company. If the holding company pays dividends to its shareholders the tax on dividends is calculated in the same manner for the subsidiary company, even if the actual results are in red. Usually the request of the fiscal authorities is declined by the holding company, in which event the fiscal authorities assess the amount arbitrarily and this matter is then referred to the Court. I know personally several such cases regarding American and Swiss holding companies. In Italy, the same difficulties will also arise, as I am "sindaco," that is auditor of a subsidiary company there, and I meet the same trouble. It will be the same in every country. In France the difficulties have been stopped for the present, after diplomatic steps, but they are only postponed—they are not over.

And here is my suggestion, presented in the name of the French Delegation: a few days before I left Paris I received from one of my friends, living in the United States, information telling me that this important question was the cause of the formation of a special commission by the League of Nations. Unfortunately I had not enough time to obtain more complete information on this subject before the Congress. We would submit that the International Congress Committee get in touch with the Secretary-General of the League of Nations with a view to ascertaining

the actual position as regards the question, and to decide how and to what extent certified public accountants in every country could cope with this problem in the best possible manner for the promotion of world commerce.

THE CHAIRMAN : We have one more speaker. After that, Sir Albert Wyon will clear up all controversial points. (Laughter.)

HERR DR. G. F. HÖRN (Germany) : Mr. Chairman, my Lord President, ladies and gentlemen, the paper that we have heard deals with most important questions and difficult problems. In my opinion shareholders have a perfect right to know in terms of pounds, so far as possible, what companies are deriving from the investment of their capital, and the best effort should be made to give them this information. In regard to valuation, it is only possible to assert a value in the sense in which it is generally understood, namely by entering into a good contract for sale with a solvent party. The solution of these problems is not to be found in legislation. That being so, we must ask ourselves where it is to be found. I would say that it must be found by the realisation of their responsibility by accountants. In Germany an attempt has been made to solve these problems which are dealt with in Sir Albert Wyon's paper by the Companies Act and the Supplementary Act of 1931. An attempt is there made to give the shareholders any information that they need and not to abandon the responsibility of the accountant. As a result of the first year's working of this law and the experience that we have acquired during 1932, we must say that it is a very good one. I will not mention all the things that are regulated and established by this law, but one of its important features is publicity, another the provision of forms of balance sheet concerning the relations between holding and subsidiary companies. I think it will be agreed in all countries that attention should be paid to the needs of the shareholders, and that accountants should be reminded of their responsibility in regard to these most important and difficult problems.

(The following is a translation of notes for a speech which could not be delivered through lack of time.)

MONS. R. JOLLET (France) : In making a small contribution to the subject of " Holding and Subsidiary Companies," I wish to present to you the *French legal* point of view, which entails the heavy taxation of parent companies and therefore modifies that part of the paper devoted to the valuation of holdings. For the sake of clarity, I shall deal with the two cases most often occurring in practice :

- (1) The parent company is English, having a subsidiary in France which is a joint stock company.
- (2) The parent company is English, the French subsidiary is also a joint stock company, but in its turn the latter owns one or more French subsidiaries which are all joint stock companies.

Case I: An English parent company with a French subsidiary.

Our attention is attracted by three main points :

Tax on dividend.

Assets exploited in France.

Commercial profits.

We shall see, however, that British maritime companies have been exempt from some of these taxes.

Tax on dividend.—Dividends or interest paid by a subsidiary are liable to a tax called income-tax, amounting at present to 16 per cent. Thus, when a French subsidiary pays Frs. 100,000—in dividend, an amount of Frs. 16,000—is withheld as tax, leaving Frs. 84,000.

Assets exploited in France.—Foreign companies, of which the shares circulate in France, and which are therefore subscribed companies, come under special regulations. But “foreign companies, the shares of which are not quoted, but are represented by movable or immovable property in France, must pay income-tax in respect of the French property involved, and the amount of this tax is a proportion of the working capital and fixed by the Ministry of Finance.”

Let us take an example: The “Northern Railway Ltd.” opens a travel office in Paris. This company carries on a business in France and the French Treasury estimates the proportionate value of this business in relation to the total capital of the company. The income-tax will be fixed at such proportion; at present it is 16 per cent.

So far the matter appears quite normal, but it has become complicated in latter years. To continue our example, suppose that the Northern Railway considers this tax too high and prefers to set up a French subsidiary, a joint stock company, to work its travel office. The English parent company is no longer liable to income-tax, since it no longer carries on business in France. On the other hand, the French joint stock company pays income tax on dividends distributed. This arrangement seems fair. However, the French Treasury intervened with a request to the courts that any foreign parent company actually in control of a French subsidiary should be considered as carrying on business in France. The Treasury gained the day, obtaining various decisions in its favour. The

result is that the parent company is liable to the same income-tax which it paid before the formation of the subsidiary, and that it pays in addition the income-tax payable by the latter company on its share of the profits. In this way, a double tax is paid.

Tax on business profits.—Up to the present, tax on business profits has, in the case of foreign subsidiaries, been estimated in France on results shown by accountants and accounting documents. There is no doubt that, by agreement, profits could be shown in either country, and therefore in that country where the tax on profits was lower.

In order to avoid the transfer of profits abroad, the Law of May 31st, 1933, has just enacted that: "In order to arrive at an estimate of the tax on industrial and commercial profits payable by business concerns which either manage, or are managed by, concerns situated outside France, profits indirectly transferred to the latter either by raising or lowering buying or selling prices, or by any other means, shall be incorporated in the results shown by the accountants. The same procedure shall apply to concerns controlled by any business or group which in its turn controls concerns situated outside France.

"Should the data necessary to effectuate the adjustments mentioned in the preceding paragraph be missing, the taxable products are estimated by comparing them with those of similar concerns in normal working conditions."

The French joint stock subsidiary may therefore have to pay an additional tax on profits, over and above the amounts payable to the parent company.

Favoured situation of British maritime companies.—It would appear that this trouble in connection with tax, suffered by parent companies, will be alleviated by international negotiations. The decree of February 25th, 1933, relieves British maritime concerns from certain taxes: "Profits resulting from the maritime industry from boats registered in ports in the United Kingdom to companies whose head office and management are situated in the United Kingdom, shall be exempt from tax on industrial and commercial profits."

Case II: An English parent company, a French subsidiary, which has a sub-subsidiary. The French subsidiaries are joint stock companies.

In this case there is a point which affects the tax on dividends. For example: the sub-subsidiary pays Frs. 100,000—in dividend. It pays Frs. 16,000 tax on this dividend. The subsidiary (if it owns all the

capital) receives Frs. 84,000 net, and in its turn pays out Frs. 84,000 and it pays a tax on dividend of Frs. $84,000 \times 16$, leaving Frs. 70,560

100

net, which it pays to the parent company if the latter owns all the working capital.

In order to avoid all this loss by taxation, the Law of July 31st, 1920, Art. 27, established the exemption from the 16 per cent. income tax.

These arrangements are of no interest *directly* to foreign companies but they are of real value to those having a French subsidiary, a joint-stock company, which itself has a subsidiary.

In conclusion, the English parent company with a French subsidiary should take into account, when valuing its holdings :

- (1) tax on dividend (at present 16 per cent.) paid by the subsidiary,
- (2) income tax on profits obtained in France (at present 16 per cent.) payable by the parent company,
- (3) possible increase of profits, and therefore possible increase of the tax payable by the subsidiary on commercial profits (at present 15 per cent.),
- (4) the plurality of income tax when the French subsidiary has itself formed a French sub-subsidiary.

THE CHAIRMAN : Just as we have had too much red ink during the last few years, we have had rather more red light this afternoon than we would like to have had, but I am happy to say, Sir Albert, that the red light has been turned off and the green light is now on, and fixed. (Laughter.)

SIR ALBERT WYON : Mr. Chairman, my Lord President, ladies and gentlemen, I can assure you I am not in the least worried by the suggestion made by the chairman although it would seem that I am to go on talking until the red light appears. I think that will be long enough. (Laughter.)

In the first place, I would like very heartily to thank each speaker for the very kind way in which he has referred to my efforts to throw some light upon this difficult problem. In particular, I would like to thank the opener of the discussion, Mr. Peloubet, for his over-generous personal remarks about myself. I have a few notes of the many varied and valuable comments and suggestions which have been made by the speakers and, if I do not take up every point, will they kindly be assured that it is on account of lapse of memory and not from want of respect for the

valuable suggestions which have been made. I do not hope, in the words of the Chairman, to clear up all the controversial points, of which I know there are many.

In the first place, I would like to refer to what Mr. Peloubet said as to consolidated accounts. I think he did not exactly follow my argument, or perhaps I did not express myself with sufficient clearness in my paper. It was not my suggestion that the assets and liabilities of subsidiary companies should be taken up in the books of a holding company. That, of course, is, as he very properly says, practically impossible and it would be of no value if it were done. But I have directed my suggestions to the inclusion in the accounts of the holding company of what are practically the earnings of the group of which the holding company forms the head. I do not think that the preparation of consolidated accounts can take the place of the preparation and promulgation of correct accounts of holding companies. It is out of the balances shown by holding companies that shareholders will receive their dividends, not out of the surplus shown by any consolidated account. Therefore, I think it is essential that consolidated accounts should not be regarded as taking the place of properly drawn up accounts of holding companies.

Mr. Klijnveld referred to the accounts of Life Assurance Companies. We know, of course, that, for years past, it has been the practice of Life Assurance Companies, for obvious reasons, to consolidate their Accounts—that is the accounts of premiums, claims and expenses and assets. As we all know, it is the practice of Assurance Companies to advertise very widely their income and their total assets. It is, therefore, to the advantage of such companies to present as large totals as they possibly can. It was the practice of many assurance companies in this country and I believe also abroad, to present what, in effect, were nothing more than consolidated accounts. Happily, within the last two or three years, there has been a change in that respect in this country, and all assurance companies now publish not only consolidated accounts but statutory accounts in which the interests of the subsidiary companies are shown, as I think they should be, as investments. Mr. Klijnveld also stated that, in his opinion, the losses made by subsidiary companies should be provided for in the accounts of the holding company and I rather gathered from what he said that the law in Holland required that to be done. If so, I think it is a very good law indeed and I should like to see the effect of it extended to other countries. He, and I think one or two other speakers also, made reference to the audit of the holding companies and the sub-

subsidiary companies respectively. I fully agree with what Mr. Keens said. It is not always desirable that the services of the auditors of subsidiary companies, where those subsidiary companies come to be absorbed in a group, should be dispensed with. There are many reasons for retaining the services of the auditors in those circumstances. But I think that the suggestion which I made at the close of my paper, to the effect that the auditors of the holding company should have the right and the facilities to enable them to make detailed inquiries of the auditors of the subsidiary companies should, wherever possible, be adopted. I am afraid I do not agree with—I think it was Mr. Klijneveld—that the mere certificate of the auditor of a subsidiary company should be regarded as sufficient by the auditor of the holding company, without further inquiry. You can all envisage, I think, circumstances in which details would be of the utmost value to the auditor of the holding company.

More than one speaker referred to my suggestion that it was wise that the whole of the profits of a wholly owned subsidiary company should be declared by that company in dividend and so taken up in the accounts of the holding company. That is not much more than a variation of the method described by Mr. Fletcher and which I have sometimes heard described in this country as a branching of profits, that is the inclusion in the accounts of the holding company of the entire profits of its subsidiaries. I prefer to see such profits legalised by being declared in dividend. I see no objection to a subsidiary company declaring the whole of its profits in dividend and actually paying it over to the holding company. I prefer to see the finance of a group in one balance sheet only, and that the holding company's. I would like to see any funds required by the several subsidiaries provided by the holding company that provision being made altogether independent of the profits earned by the subsidiary companies. I do not think that the needs of the subsidiary companies ought to be measured in any respect by the dividends which they might declare. In the same way, I should like to see reserves—I mean free reserves, not reserves for expenses or depreciation or amortisation—appearing in the accounts of the holding company so that they will be laid before the public, who are the shareholders.

Let me confirm what Mr. Morgan was kind enough to say, that my views on holding companies are identical with those of my late and much lamented partner, Sir Gilbert Garnsey. He and I have had many a talk on these subjects and our views have been crystallised first of all in his book and now, in a much less elaborate

and formal manner, in this paper which has been laid before you.

I must ask any speaker with whose remarks I have failed to deal to accept my apologies because, as I think I said, the comments made came so quickly and they were so full of substance in every case that I have only touched on those of which I have been able to take a note.

THE CHAIRMAN: The Congress is now adjourned until 10 o'clock to-morrow morning.

TUESDAY EVENING

VISIT TO THEATRE

Delegates and visitors, with their ladies, numbering in all 205, attended the evening performance of " Music in the Air " (a musical play presented by Mr. Charles B. Cochran) at His Majesty's Theatre, Haymarket. From all accounts the play was much appreciated.

WEDNESDAY, 19th JULY, 1933

Morning Session

CHAIRMAN: Mr. J. McLAREN BIGGAR, F.L.A.A. (*President
of the London Association of Certified Accountants*).

HONORARY } Mr. JOHN PARTON, F.C.A. (Canada).

CHAIRMEN { Mons. J. POLAK (Holland).

PAPER

“The Control of Charges and Profits of Statutory Undertakings in (1) Private or (2) Public Ownership and the Accounts Relating Thereto, e.g. (a) Railways, (b) Docks and Harbours, (c) Water, (d) Gas, (e) Electricity and (f) Tramways

MR. WILLIAM CASH, F.C.A.



MR. JOHN M. BIGGAR, F.L.A.A.
*President of
The London Association of Certified Accountants*

THE CONTROL OF CHARGES AND PROFITS OF
STATUTORY UNDERTAKINGS IN (1) PRIVATE OR
(2) PUBLIC OWNERSHIP AND THE ACCOUNTS
RELATING THERETO, e.g.

(a) RAILWAYS, (b) DOCKS AND HARBOURS, (c) WATER, (d) GAS,
(e) ELECTRICITY, AND (f) TRAMWAYS

BY

WILLIAM CASH, F.C.A.

In introducing to you this paper, I desire to say at the outset that I have found the subject a very large one ; it covers the activities of very many undertakings, most of which are of primary importance to the public at large. Indeed, my principal difficulty has been to condense into reasonable space and without going into unnecessary detail what might be said under each of the heads referred to in the title. It seems to me that the matter may be of interest at an International Congress because, no doubt, similar control of charges and profits must arise in other countries and I venture to express the hope that accountants from abroad may find an interest in the methods employed in the United Kingdom and may be able also to contribute from their own experience examples of the manner in which similar matters are dealt with in other countries.

Furthermore, from the accountants' point of view, apart from the general interest attached to such matters, questions of accountancy are involved and, moreover, accountants, particularly those who specialise in such matters, are very frequently consulted in proceedings dealing, in the first place, with the authorisation of charges and the limitations of profits and also again when the question of revision of such charges arises. Also accountants, in the great majority of cases, are concerned as auditors of the undertakings with which I am dealing and, in this capacity, are interested in the powers and

control in force in respect of the particular business. There are many cases where companies, domiciled in the United Kingdom, are carrying on business abroad and their operations in foreign countries are regulated and controlled as regards their charges and such control even extends to the regulation of wages, charges for depreciation and, in some cases, limitation of profits. I have found that the matters I have dealt with are sufficiently lengthy to preclude the inclusion herein of reference to such cases as these ; but, here again, there may be an opportunity for our friends from abroad to give us details of the methods employed.

The accounts of statutory undertakings are designed to give effect to special legislation relating to the control of the charges and profits of such undertakings and are intended to show the working results of the businesses carried on, and, in order to appreciate the position, I would ask you to remember that such control, in most cases, is two-fold ; inasmuch as it relates to both charges and also profits. Statutory undertakings are referred to often as quasi monopolies and, as a result, are controlled or regulated by statute and this, of course, has a political significance because statutory undertakings are given exceptional powers but are placed under statutory obligations. It is necessary that they should be endowed with statutory powers to enable them to fulfil their functions but, because they are fulfilling duties to the public, limitations as to charges have been devised by the legislature and, in many cases, profits have been limited or regulated both by Public and Private Acts of Parliament. Certain of these Acts have been in force for a long period of years. Individual undertakings are incorporated under the provisions of individual Private Acts of Parliament which grant the necessary powers to carry out certain work within specified areas and, in the great majority of cases, these particular Private Acts incorporate the provisions of the relative Public Acts. It follows, therefore, that companies which are working under these constitutions have a different status to the ordinary limited company, registered under the Companies Act, 1862, onwards, culminating in the Companies Act of 1929. These statutory undertakings, which are not limited companies in the technical sense, nevertheless, so far as their stock-

holders are concerned, have a limited liability. The largest and most important group of companies so constituted is that comprising the railway companies and they, with the gas and water and certain other statutory companies, are governed, as far as their administrative actions are concerned, by the Companies Clauses Act, 1845. There is another class of undertaking clothed with statutory powers which I may describe as public boards. These are not companies but have powers to raise capital and earn profits but their powers of charge and the allocation of their profits are controlled by the legislature. In this category are included such undertakings as the Metropolitan and other Water Boards, the Port of London and other Dock and Harbour Boards and also joint electricity authorities. A further group of undertakings includes those carried on by municipal corporations and other local authorities and relates to the supply by the owners of such things as water, gas, electric energy, tramways, and in other activities such as markets or, in a few cases, banking.

Historically, the water companies reach back to earlier days than before railways were thought of and there are a few other companies still surviving with Special Acts relating to such undertakings as toll bridges and, at a somewhat later date—say, 100 years ago—to gas companies. Of still more recent origin are the tramways and last, but not least important, the electricity undertakings.

On the question of monopoly, it is interesting to consider how, in the passing of time, one industry has followed another and the alleged monopoly has been threatened by competition which at its initiation was not even thought of. For instance, the railway companies ousted and superseded the old stage coach and now they, in their turn, are threatened by road transport which at the present time is making serious inroads into their receipts and profits. No serious rival has been found yet to the water undertakings and water is a prime necessity of life and health under modern conditions; gas has to meet competition by oil and electricity, while even electricity, in certain directions, has to meet the competition of the oil engine and of oil fuel. Tramways have had to fight against the competition of the motor omnibus and are sometimes alluded to as an obsolete

system of locomotion although, with the help of electricity, the tramways have regained much of their usefulness. Again, those of us who look into the future may feel inclined to prophesy, as far as transport is concerned, that air transport may develop into a serious rival. I think it may be interesting in considering these subjects to spend some time on the historical side of these matters and to divide our subject under the various heads enumerated above.

RAILWAYS

Railways have been described as entirely the creations of statutes. Parliament created them,* launched them upon their existence and has regulated and controlled them throughout. In the early days of railways, during the railway boom of 1839, no less than 1,263 companies, representing a gross capital of £563,000,000, deposited plans with the Board of Trade for new lines. The various systems were sanctioned because there was traffic to be served and, having been given the powers which Parliament granted, very large sums of money have been spent by the railways in creating their undertakings, but no person, except on his own private property, may lay down a railway without coming to Parliament who arms the promoters with compulsory powers which are necessary to enable them to expropriate landowners and thus obtain the land necessary for their permanent way. But, at the same time, Parliament limits their authority to carry on business to the actual and direct powers granted and to other business reasonably ancillary thereto so that a railway company can deal with collected and delivered traffic (C and D) ; that is to say, they may call for the goods intended to be sent by rail and may deliver them after transit. Parliament has allowed also the railway companies to engage in the ownership of docks and the running of steamers and the working of hotels.

Historically, railway companies were intended to provide a specialised road with rails with the right to the public to use that roadway as a highway and the railway companies were to be remunerated by a charge or toll and, in the first instance, were not necessarily to provide either locomotives or vehicles and it is for this curious reason that railway companies' charges are still referred to

as "tolls and charges." This fact is seen in the first Act of 1823 (Stockton and Darlington), where there is a provision for the passage of coaches, gigs and landaus on the roadway, the owners of these vehicles being supposed to provide wheels to fit the railways and use them themselves. In the London, Brighton and South Coast Railway Act of 1845 the company were given power to provide their own engines, carriages and trucks and to become carriers. It was apparently contemplated that other vehicles might use the railway subject to regulation as to departure, arrival and speed, arriving on the railway from private sidings. In fact, at that date, merchants undertook the receipt and dispatch of goods apart altogether from the company.

In the Railway and Canal Traffic Act of 1854 the companies were bound to :—

"Afford all reasonable facilities for the receiving and delivering of traffic upon and from the several railways and canals belonging to or worked by such companies respectively, and for the return of carriages, trucks, boats, and other vehicles, and no such company shall make or give any undue or unreasonable preference to or in favour of any description of traffic, in any respect whatsoever, nor shall any such company, subject to any particular person or company, or any particular description of traffic, to any undue or unreasonable prejudice or disadvantage in any respect whatsoever."

This section of the 1854 Act is of historical importance because it brought into existence what is known as "The undue preference" clause and the right to the trader to reasonable facilities and the same Act also introduced certain maxima for the charges. These charging powers of the railways were revised under the Railway and Canal Traffic Act of 1888 by a classification of the goods when uniformity in regard to all the railways was introduced. Under the same Act provisions were inserted whereby the charges for carriage varied according to whether the company provided the wagon or the trader ; in the latter case a rebate was allowed from the charge. These charges covered various kinds of services, including collection and delivery, terminal charges and conveyance charges and orders

under the powers of this Act were made for each individual railway company. Charge for detention or demurrage of vehicles was also another authorised charge.

Since the railways were instituted first, the companies have provided stations and places for the reception and dispatch of goods and provisions were made for the protection of the public so that a trader, when quoted or charged a rate, was entitled to call upon the railway company to analyse, or split up, the rate between the charge for carriage and that for terminal services. An amending Act of 1894 followed and contained elaborate provisions with regard to the revision of rates which placed the onus on the company of proving that an increased rate was reasonable but this provision has now been repealed by the Railways Act of 1921. Parliament in 1913 gave the railway companies power to increase their charges due to increased costs arising from revision of rates of pay and the Railway Companies Accounts and Returns Act of 1911, which came into force in 1913, settled the present statutory form of accounts applicable to railway companies. In the meanwhile, war broke out in 1914 and the Government took over the control of the railway companies under certain powers contained in the Regulation of the Forces Act 1871, and, under such control, the companies were, in effect, guaranteed the revenue which they had actually earned in 1913, the last complete pre-war year. But after the war it was obvious that the position required special treatment and the railways were, in effect, reconstituted under the Railways Act of 1921 and that is the Act which governs the position to-day. This brought into force a new principle. Beyond control of maximum charges the companies were previously entitled to earn such profits as they could. Under the 1921 Act they were given standard rates and charges designed to bring in a standardised revenue. A new authority was set up termed the " Railway Rates Tribunal " which proceeded to settle the rates and charges on this basis, and the companies are under obligation to make these charges (Section 32). But the Act provided a sliding scale ; if the companies earn more than the standard revenue, they are allowed only to retain 20 per cent. of such excess and the balance is to be applied to the reduction of rates. The Act carried out also an

amalgamation of the various companies so that to-day there are only four main-line companies. The importance of the alteration in charging power lies in the fact that there are no longer maximum charges but these are now described as standard charges fixed by an independent tribunal.

Unfortunately, whilst it is relatively easy in theory to fix a standard revenue and standard charges, it is not so easy by such a method to ensure that the actual revenue will produce the anticipated result. Whilst the Act contemplated an equilibrium and a possible raising of rates to give the standard revenue, such raising of rates would tend to defeat the object aimed at by discouraging traffic, especially at the present date when such traffic is competitive, nor would the equilibrium be obtained by increasing the charge on one class of traffic to make up for the decrease in another. The question of how far the railway companies shall be allowed to compete on the roads is a matter of urgent consideration to-day. The railway companies are entitled to compete on the sea, but on land the fear has been expressed that, by reason of their financial power, they might crush those engaged in road transport. On the other hand, the present financial state of the railways is a matter of such national importance and so large a sum of money is invested in the railways that their financial position is one of prime importance. Nominal capital expended by railways in this country is, approximately, £1,300,000,000.

Political difficulty lies in the holding of the balance between the railway companies and their competitors. There is a risk that they might crush the independent hauliers by working the road traffic without profit to the detriment of the hauliers and that a combination between the railway companies and the road interests might jeopardise the interests of the public who require cheap and efficient means of transport.

Before leaving the question of charges, I ought, perhaps, to refer to the matter of exceptional rates, this being one of considerable complication. Prior to the 1921 Act, the companies had upon their rate books exceptional rates running into millions; in fact, it has been said that the exceptions swallowed up the rule! The 1921 Act

provided for the continuance of the exceptional rates which at the appointed day the traders desired to have continued, and new exceptional rates were allowed to be granted by the railway companies within certain limits subject to their being reported to the Ministry of Transport, with a limitation on the deduction from the standard rate, and subsequent variations are liable to control by the Rates Tribunal with further provision against cutting rates. As showing the basis on which the standard revenue was to be calculated, I have extracted Section 58 of the 1921 Act (see Appendix A). I have added also Section 59 which deals with the review of charges. So much for the control of charges and profits as far as the railway companies are concerned.

Now as to the form of accounts. These are very voluminous and follow the provisions of the 1911 Act and are expanded by the statistics to be supplied to the Ministry of Transport by the companies as set out in the 1921 Act, Eighth Schedule. The accounts had one particularly interesting feature for the accountant. In the early days of the railway companies, the revenues were built up on the receipts of the period and the expenses included the actual cost of the repairs and renewals which fell within the account year. In the broadest sense, no allowance was made for depreciation. In later years, when the companies undertook the working of steamboats, it being obvious that the renewals of the boats must fall in infrequent and at lengthy periods, the companies concerned provided depreciation funds for ships. Certain of the companies also built up in effect a reserve or depreciation fund by the provision of surplus rolling stock and, in this way, anticipated renewals. Then, at a later date, some of the larger companies, who came to be known as "programme companies," definitely introduced depreciation or renewal funds scientifically calculated, particularly in connection with rolling stock. The 1911 form of accounts recognised this principle and it will be seen by reference thereto that provisions by way of transfers from or to renewal funds were contemplated. Sums which the companies received by way of compensation for deferred renewals and excessive wear and tear, which accrued during the period of Government control and were paid by the State under the provisions of the 1921

Act, were applied by the companies to the appropriate renewal funds and formed the basis of the considerable sums which the companies to-day hold in such funds.

I do not propose to include here any discussion on the working of these funds, their adequacy or inadequacy, but, when they were constituted, the very important question of the adequacy of the funds was discussed, having particularly in mind the question of the added cost of renewal on a post-war basis of assets acquired by a pre-war capital expenditure. The general scope of the accounts is, I think, apparent. A capital account gives details of capital expenditure during the year ; a summarised revenue account and appropriation account are supplemented by detailed accounts under each main head of expenditure and separate revenue accounts for ancillary businesses and, finally, a balance sheet. Statistical information is afforded as to the principal classes of rolling stock and ships owned by the company, mileage of the permanent way, train mileage, permanent-way repairs, renewals and repairs of locomotives, carriages and wagons and, finally, a comparative statement of results in preceding years. The railway companies have been relieved of the necessity of furnishing this account in full to all their shareholders and a summarised statement, comprising the particulars appearing in the full statements of accounts as to the revenue account and appropriation account with the balance sheet and certain of the statistical information, is to-day sent to the proprietors with an indication that a full statement of accounts can be had on application to the company.

The statistics required under the 1921 Act are very elaborate. To deal with them in detail would take too long. Many of them have to be supplied monthly. They include freight receipts in tons and ton units, parcels and miscellaneous receipts and quantities, train and engine miles with consumption of coal, electricity and oil by locomotives, &c.

The accountancy involved in the "disintegration of exceptional rates" (1921 Act, Section 40) on the ascertainment of a terminal charge is an elaborate matter. I might instance a case which allows in the cost for interest on capital, maintenance, and working cost of a signal box used for a particular traffic on the basis of the proportion-

ate number of lever movements in the box attributable to the traffic in question.

WATER

Historically, I suppose, one of the earliest public supplies in this country was inaugurated by the New River Co. which was incorporated by Letters Patent in 1619 with the title of "The Governor and Company of the New River brought from Chadwell and Amwell to London." The New River Co. is still in existence but as a limited company registered on the 1st July 1905, pursuant to an Act of Parliament in 1904. The company, of course, has been deprived of its water undertaking which was transferred to the Metropolitan Water Board as from 25th July 1904, and the company is now really a land and property company, owning estates, houses and property not connected with water supply. There is also the case of the supply afforded to-day in Plymouth and owned by the Plymouth Corporation which still uses the water from Drake's Leat, the supply having been inaugurated by Sir Francis Drake and authorised under the Plymouth Water Act of 1585. No doubt, there may be other similar enterprises but these two will suffice for our purpose.

The earliest supply of water in London was provided by an engineer of the name of Peter Morrys who in 1582 obtained permission from the Corporation to pump water from the Thames into the City by means of water wheels placed in the first arch of London Bridge and driven by the tide. It is said :—

"Before this time no such thing was known in England as this raising of water. It was done by a mill and was the first waterwork that was made use of to supply the Citie of London with Thames water ; and this water-mill furnished the neighbouring parts of the Citie as far as Gracechurch Street." (*Stowe.*)

This system, inaugurated under a 500 years' lease from the Corporation, was extended as time went on until five arches of the bridge were occupied with waterwheels and supplied the City for 240 years and the borough for 50. This undertaking came into the hands of the New River Co. in 1822 and, subsequently, into the ownership of the Southwark and Vauxhall Water Co. Prior to this public supply Londoners were dependent on private shallow wells or

polluted brooks or were supplied with water drawn from the river by men known as "Cobs" who carried water round to the houses in "tynes," or buckets, at a charge of 1d. or $\frac{1}{2}$ d. per bucket. They formed a sort of guild and resented any interference with their privileges.

The New River Co. was the work of private enterprise. The City Corporation declined to undertake the work for which they had obtained powers and thus recorded their decision :—

"The Maior, Comaltie and Citizens considering the great charge and expense of the saide worke and doubtinge much losse might befall upon the Chamber of the said Citie, in case worke should not succede well and prove beneficall, did thereupon forbear at their common charge to undertake the saide worke soe as the same lay long neglected and unlike by them to be p'formed."

Sir Hugh Myddleton came forward and undertook the work himself with :

"divers persons of quality who were willing to adventure and joyne with him in contribucion towards the charge of saide worke."

That was the origin of the first London water company. The New River water was brought to London in 1613 and was received with a great flourish of trumpets as a public benefaction. It was distributed in pipes over a wide area and laid on in the houses, the use of the service pipe and taps being granted on lease for an annual payment. Under its constitution half the profits were to go to King James who had borne half the expense of construction ; but, as losses ensued instead of profits, in the year 1631 Charles I disposed of his share to Sir Hugh Myddleton for the consideration of £500 a year to be paid in perpetuity to the Crown under the name of "The King's Clogg." The remaining half of the waterworks consisted of 36 shares, of which Sir Hugh Myddleton held 13. The important point to observe is that no public authority in the early days did anything to supply the needs of the public. Many of the early water companies paid no dividends for years and none of them made much profit at first, and this should be remembered when sums paid in later years for water undertakings are referred to.

The next London company in order of date was the East London Co., established in 1681, and the Chelsea Co. in 1723. It would take too long here to deal with the history of all the London companies and with their efforts to improve the quality of the Thames water by storage and filtration. Of the early works of the New River Co., the "Waterhouse," erected about 1613 and restored in 1872, still exists and contains the old oak room which has been built in to the existing offices and to-day forms part of the offices of the Metropolitan Water Board and is situated on the site of the New River-head in Rosebery Avenue, Holborn.

In London areas had been devised for the eight water companies which were in existence when their undertakings were taken over by the Metropolitan Water Board under the Act of 1902 in the year 1904. Their dividends were limited by Act of Parliament to 10 per cent. but, of course, this applied only to the ordinary capital; any excess profits had to be applied to the reduction of rates and their charges for water were limited. In the early days of the New River Co. the charge for domestic water laid on to a house was calculated by the number of chimneys in the house which was a rough guide to the size of the dwelling. No doubt, the companies were prosperous undertakings; in fact, the New River Co., whose capital in 1852 was deemed to be £1,519,958, received in the arbitration in 1904 £6,534,000 in Metropolitan Water "B" 3 per cent. Stock and, in addition, the Board took over debenture stock amounting to £1,258,000 and the company retained the landed estates. A King's share, which then represented £2,844 a year, realised in 1899 £120,000. The total consideration money to the eight companies, paid by the Metropolitan Water Board under the 1902 Act, amounted to £42,854,128, which was paid by the issue of 3 per cent. stock, this irrespective of further outlay in connection with the transfer, compensation, stamp duty, &c.

Water companies, generally, in obtaining Parliamentary authority acquire compulsory powers, if necessary (except where they proceed by provisional order), to take land and water rights; power to break up the streets, under superintendence, for the laying and renewing of their pipes; power to charge rates not exceeding the authorised

maximum, based on the rateable value of property, and power to require payment of the same quarterly in advance ; and power to recover such rates by the summary method of distraint with a further power of cutting off the supply ; and the company's water supply is protected by penalties against the fouling, waste or misuse of it. On the other hand, the company may be compelled, under the conditions provided, to afford a supply of pure and wholesome water, unless prevented by frost, unusual drought or other unavoidable cause or accident ; and their profits are restricted to 10 per cent. on their ordinary or original capital. In many cases the supply is required to be constant.

Existing water companies are protected against local authorities intending to give supplies under the Public Health Act of 1875 so long as such companies are able and willing to supply water proper and sufficient for all reasonable purposes so that, under the provisions quoted, the company has a monopoly. Charges of each individual company vary, it being the practice of Parliament to allow such charges as will give a reasonable return on the capital involved. Under the Gas and Water Works Facilities Acts, 1870 and 1873, Provisional Orders, subject to confirmation of Parliament, may be obtained by any companies or person. Companies are allowed to charge for water supplied for trade purposes according to the quantity supplied. In many cases, there is a limit on the quantity which may be required by any individual consumer. The law has established the fact that there is no property in underground percolating water but a company, when authorised to sink a well, may find themselves saddled with clauses whereby within a stated radius of such well, compensation may be payable to any person injuriously affected. There have been numerous decisions as to what is a domestic supply, a matter which it is not necessary to discuss here.

Water companies have, in many instances, been transferred by purchase to local authorities but, as a general rule, Parliament will not compel a purchase and transfer unless there is real ground for complaint against the existing water company.

So far as financial provisions are concerned, these are contained

mainly in the Waterworks Clauses Act of 1847. Section 75 provides that the profits to be divided shall not exceed the prescribed rate or, where no rate is prescribed, shall not exceed 10 per cent. on the paid-up capital unless a larger dividend be at any time necessary to make up the deficiency of any previous dividend which shall have fallen short of the said yearly rate. This, in effect, enables a company to pay "back dividends" and many companies who, in years gone by, paid little or no return to their shareholders are, in this manner, recouped for the lean period which they, as pioneers, have encountered.

Additional capital was fixed generally at 7 per cent. for ordinary capital and 5 per cent. for preference capital but this additional capital, under the private Acts in compliance with standing Orders of Parliament, has to be offered by public auction or tender at the best price which can be obtained.

The Waterworks Clauses Act, Section 76, is important and I quote it verbatim :—

"If the clear profits of the undertaking in any year amount to a larger sum than is sufficient, after making up the deficiency in the dividends of any previous year as aforesaid, to make a dividend at the prescribed rate, the excess beyond the sum necessary for such purpose shall from time to time be invested in Government or other securities and the dividends and interest arising from such securities shall also be invested in the same or like securities, in order that the same may accumulate at compound interest until the fund so formed amounts to the prescribed sum, or, if no sum be prescribed, to a sum equal to one-tenth part of the nominal capital of the undertakers, which sum shall form a reserved fund to answer any deficiency which may at any time happen in the amount of divisible profits or to meet any extraordinary claim or demand which may at any time arise against the undertakers; and, if such fund be at any time reduced, it may thereafter be again restored to the said sum and so from time to time as often as such reduction shall happen."

I should add that by the next section money cannot be taken from

the fund for the purpose of meeting an extraordinary claim unless it is certified first by two Justices.

Section 78 is as follows :—

“ When such fund shall, by accumulation or otherwise, amount to the prescribed sum or one-tenth part of the nominal capital, as the case may be, the interest and dividends thereon shall no longer be invested, but shall be applied to any of the general purposes of the undertaking to which the profits thereof are applicable.”

Under Section 79 a deficiency in profits may be taken from the reserve fund. Under Section 80, when the reserve fund is full, all surplus profits must be applied to the reduction in the water charges. Under the same Act is a requirement to make up an annual statement of accounts which has to be certified by the auditors and a copy sent to the Clerk of the Peace of the County in which the waterworks are situated. No form of accounts is prescribed but the practice amongst water companies has produced a considerable amount of uniformity in a revenue account so that the expenditure side is generally set out under the following heads :—

Maintenance of Works.

Pumping.

Filtration.

Purchase of Water.

Maintenance of Mains, Meters, &c.

Salaries of Engineers.

Rent, Wayleaves.

Rates and Taxes.

Management and Collection.

Law and Parliamentary Charges.

On the other side is shown the income from water and other subsidiary accounts. The balance is transferred to a profit and loss or final appropriation account, the balance sheet being in the usual form introducing the balance of capital raised and expended, the floating assets and the liabilities under the appropriate heads.

It may be of interest to refer to the case of the Metropolitan Water Board as an example of a Board as distinguished from a company.

Under the provision of the Metropolitan Water Act, 1902, the above Board took over the undertakings of the eight water companies and the transfer took place in 1904. The charging powers of the companies under the Metropolitan Water Board (Charges) Act, 1907, were continued for a time and then unified for the whole area of supply on the basis of a charge not exceeding 5 per cent. on the rateable value for water for domestic purposes and a charge per 1,000 gallons for water supplied for trade purposes, the Board having the right to call upon constituent bodies to make good any deficiency in revenue, including the charge for interest on loans and debentures and sinking fund. In fact, a deficiency occurred during every year of the Board's existence until a further Act in 1921 readjusted the charges so that the 5 per cent. became at such rate per annum as the Board shall from time to time fix not exceeding 10 per cent. The loan period granted by the 1902 Act for the purchase price was the exceptionally long one of 100 years (with suspension of the sinking fund for 20 years), and for other subsequent capital 60 years or less. The revenue of the Board has to be estimated each year and the rate charged is to be fixed so as to balance the account. In effect, the Board are precluded from making surplus profits.

GAS

Here again, as with water, Parliamentary authority for the supply of gas is obtained by special Act or by a Provisional Order, afterwards confirmed by a Public Act, or by an Order made by the Board of Trade. Parliamentary authority having been obtained, certain consequences follow: the company obtain power to construct their works and, if need be, to take defined land compulsorily but only if authorised by a Special Act; they have certain limits of supply assigned to them; they obtain power to break up the public streets for laying and repairing mains and pipes. They obtain power to charge a certain price and are given summary remedies for recovering that price by cutting off the supply and by warrant of distress as well as by action in any Court of competent jurisdiction. On the other hand, the company come under many obligations and restrictions. They are restricted to definite lands for the manufacture and

storage of gas ; they may be compelled by consumers to afford them, under certain conditions, a supply of gas, and such gas must be of the prescribed thermal value, pressure and purity ; they submit to a statutory limit of divisible profits and, in certain events, to the auction clauses (afterwards referred to) when new capital is authorised to be raised.

A gas company, is, therefore, also a regulated monopoly in the sense that no other supplier of gas can compete with it but, of course, under modern practice, the competition by electricity and oil has to be met. There are cases of companies supplying both gas and water but it is usual in these cases to require the accounts of each undertaking to be kept separately. Under the Gas Works Clauses Act of 1847, Section 30, the profits to be divided are not to exceed the prescribed rate or, where no rate is prescribed, it is not to exceed 10 per cent. unless a larger dividend be at any time necessary to make up the deficiency of any previous dividend which shall have fallen short of the said yearly rate, and there are similar provisions as in the case of water as to the creation of a reserve fund and a reduction of charge when the said fund is full. Similar clauses are inserted usually in regard to the raising of new capital as in the case of water. The practice under the Private Acts since 1874 has given additional funds, such as an insurance fund to meet extraordinary claims, a reserve fund to be limited to the purpose of making up dividends and, where the sliding scale of dividend has been introduced, the companies have been allowed also to form a special purposes fund for renewals, while the old reserve fund can be added to only out of profits authorised for distribution but not divided.

The first gas company formed in London was the " Gas Light & Coke Co.," which was incorporated by Royal Charter dated 30th April 1812, on the terms of an Act of Parliament passed three years previously, for the purpose of lighting the cities of London and Westminster and the Borough of Southwark. This was followed by the establishment of five other companies—the City of London Gas Light & Coke Co., the Imperial Gas Light & Coke Co., the Ratcliff Gas Light & Coke Co., the Phoenix Gas Light & Coke Co. and the Independent Gas Light & Coke Co.—which were, severally, incor-

porated by Act of Parliament in the years 1816, 1820, 1823, 1824 and 1829 respectively.

At one time there was competition between the various London companies, of which there were thirteen, but these have been reduced now to four, viz. : the Gas Light & Coke Co., the South Metropolitan Gas Co., the Wandsworth Gas Co. and the Commercial Gas Co. The first two companies celebrated their centenaries in 1912 and 1924 respectively and are undertakings of considerable magnitude. The first named has an issued capital, including loan capital and premiums, of £40,000,000, of which £18,911,000 is sliding scale capital ; employs some 17,000 people and supplies gas over an area which extends from Staines to Southend. It is the largest gas undertaking in the world and its annual sale of gas amounts to 49,000 million cubic feet and of its 1,370,000 consumers, 760,000 are supplied on the penny-in-the-slot principle. There are many gas undertakings in the hands of municipal authorities outside London, e.g. Birmingham, Manchester, &c., but there are to-day some 430 statutory company undertakings with a total issued capital, including loan capital, of, approximately, £123,000,000.

About 1875 the sliding scale was introduced on the following basis :

- (1) That the initial price and quantity of gas shall be fairly fixed, having regard both to the immediate existing interests of the companies and the consumers and to the prospects of both under the new system.
- (2) That the price and dividend shall vary in certain fixed proportions without limit ; so that, on the one hand, the price may be raised without limit as the dividend diminishes, and so that the dividend may be increased without limit as the price diminishes.

The effect of this was to bring the company and consumer into partnership. This principle has been extended far beyond London and has, undoubtedly, had most beneficial results both to the consumers and to the companies and, coupled with the auction clauses, has resulted in capital being raised on most advantageous terms. The auction clauses in their application required new capital to be issued by auction or tender to the public so that such new capital

was obtained on the most favourable terms with the result that the charge for remuneration of capital was as low as possible. In more recent years this provision has, in some cases, been relaxed subject to certain control by the Board of Trade or by bringing the price of issue into relation with current market quotations.

The initial or standard price for gas having been fixed, the relation between price and dividend was that for every reduction in the price of rd. per 1,000 cubic feet, the company was authorised to increase the dividend authorised by 5s. (one-quarter) per cent. on the original or sliding scale capital of 10 per cent., and *vice versa* for every increase in the price of gas the dividend had to be correspondingly reduced, relative proportions being applied to capital bearing a smaller standard rate of dividend. This method was intended to reward the gas companies for good work and economies effected and, at the same time, with this incentive, secure to the consumers a share of any advantages that might accrue to the business. The proportion of the benefit divisible on an approximate basis is five-sixths to the consumers and one-sixth to the company.

The calculation of the dividend, so far as the price of gas is concerned, is determined by the highest price of gas charged to the consumer during the current half year or year, and this took no account of discounts allowed or lower prices in force to large consumers. This part of the system was hardly fair to the shareholders and, commencing in 1920, a new method of calculation has been approved by Parliament which compares the actual revenue receipts for gas with what might have been charged at the "basic price" or standard rate, the difference being termed the "consumers' benefit"; that is, the reduction in charge which the consumers have enjoyed already. The companies are then permitted to distribute to their shareholders, by way of additional dividend, a sum of money equal to one-sixth of the consumers' benefit and, at the same time, another equal sum to their employees. This is a statutory right of the workpeople, subject, of course, to there being profits available to provide for both these additional sums. The basic prices fixed since 1920 for about 20 companies, representing about 50 per cent. of the gas sold by companies, have had regard to the

conditions then existing but before this, during the war years, public utility undertakings found themselves in difficulties by reason of the great increase in wages and the high cost of coal and other materials. Unlike an ordinary trader or manufacturer, they were unable to increase the price of their commodities to cover them, or, if they could do so, they were penalised in their dividends for no fault of their own. Accordingly, Parliament intervened and, in the first instance, passed the Statutory Undertakings (Temporary Increase of Charges) Act, 1918, whereby some measure of financial relief was granted. This Act has expired now. This was but poor and inadequate justice and in 1920 was passed the Gas Regulation Act, 1920, subsequently modified by the Gas Undertakings Act, 1929. Under the 1920 statute the Board of Trade was authorised by Order to revise the provisions as to charges in all Private Acts and so to raise the maximum or standard charge to cover the extra cost over pre-war figures to the extent of the increased costs beyond the control of the company. With this was linked the thermal method of charging for gas and provisions as to revision of prices, penalties, &c. The Act created also a new and simplified procedure for obtaining statutory powers by special order granted by the Board of Trade. Some 500 undertakings under these provisions obtained a standard, or maximum, price, when costs were on a high post-war level and but few of these subsequently had such prices reduced by an amending order. Under the 1920 Act certain amending orders were made granting undertakers a higher standard price for a temporary period during the coal strike of 1926. This Act contains also provisions for subsequent revision downwards at the instance of the Local Authorities in the event of costs falling but reserving for the benefit of the undertakers any economies effected by them in the meanwhile. Similar provisions were enacted also for the benefit of the water undertakings in the Water Undertakings (Modification of Charges) Act, 1921, and for tramways under the Tramways (Temporary Increase of Charges) Act, 1920, the administration being respectively in the hands of the Ministry of Health and the Ministry of Transport. So far as gas is concerned, the working of the 1920 Act has been modified slightly and extended by the Gas Undertakings Act, 1929,

and, thereunder, reserve and special purposes funds may be enlarged.

By the Gas Regulation Act, 1920, all gas undertakings have to furnish to the Board of Trade an annual account and such statistics and returns as the Board may require. This provision is intended to supersede the provisions of the Gas Works Clauses Act, 1871, under which a form of statutory accounts was laid down although the Board of Trade have not, in fact, prescribed any new form. Statistics are in two parts : one relating to the details of the manufacture and the supply of gas and the other relating to finance and prices. The accounts comprise the following :—

- (A) Statement as to capital authorised, issued and to be issued.
- (B) „ as to Loan Capital „ „
- (C) Capital account showing capital expenditure and capital raised, the balance being carried to the balance sheet.
- (D) Revenue account. Expenditure grouped with subsidiary items under :—

Expenditure : (1) Manufacture.
 (2) Distribution expenses.
 (3) Rates.
 (4) Administration.
 (5) Sundry itemised expenses such as
 Law costs.

Receipts : (1) Sale of gas—showing quantity sold.
 (2) Rents of meters, stoves, &c.
 (3) Residuals.
 (4) Sundries.

The balance is transferred to :—

- (E) Profit and loss (net revenue) account :—

Debit : Debenture and other interest.
 Transfers to reserve.
 Interim dividend.

Credit : Balance from last account.
 Balance from revenue account.
 Interest.

The balance (profit available) as per balance sheet.

Balance sheet.

Debit : Balance from C. and E.
Reserve and other funds.
Interest due or accrued.
Creditors.
Credit : Balance from C, if overspent.
Investments of funds.
Stocks.
Debtors.
Cash.

(F) is statistical with figures in tons of coal stocks and coal carbonised and gallons of oil used.

(G) is similar with figures relating to residuals, i.e. coke, tar, sulphate of ammonia.

From these accounts costs per 1,000 cubic feet or per therm sold are invariably prepared and the working of the company can be criticised.

ELECTRICITY

There are a considerable number of Acts dealing with the supply of electricity beginning with the Electric Lighting Act, 1882 and ending with the Electric (Supply) Act, 1926. These apply only to bodies or persons who are authorised to supply electricity within any area by licence or, since 1919, by a special order made by the Electricity Commissioners or by a Special Act of Parliament. Since 1909 no persons can commence to supply in any area in which any other local authority, company, &c., are duly authorised to supply, so as to interfere with any such company (e.g. railway companies), who were supplying prior to that date. It follows, therefore, that authorised undertakers have a monopoly of supply within their own area. It would be outside the scope of this paper to deal in detail with all this large mass of legislation and variations in the method of authorising supplies now in force nor do I propose to deal with the powers of the Electricity Commissioners which are of considerable extent. As far as companies are concerned, their capital is limited only by their memorandum of association or incorporating Act. Unlike most statutory concerns, electricity companies are

subject to purchase by local authorities under terms contained in the Electric Lighting Act, 1888.

Companies (subject to certain protective provisions) must give a supply throughout the specified number of streets in the Order. The method of charge and maximum prices is prescribed and the charge must be either by the actual amount of electricity supplied, the quantity contained in the supply or some other method approved by the Ministry of Transport. The prices to be charged are not to exceed those stated in the Order and these maxima vary between summer and winter quarters. As a rule, these maxima are inoperative, having been fixed at a high rate. Prices and the method of charge may be varied by the Ministry of Transport after three years. Temporary relief as to charges is given by the Statutory Undertakings (Temporary Increase of Charges) Act, 1918, and about 150 applications for revision were dealt with by the Ministry of Transport (this Statute has now expired). Undertakers must not show any undue preference to any consumer. The Electricity Supply Acts contain no provision limiting profits of undertakers who are not local authorities and it is not the practice to insert in such provisions any special terms but, as and when bulk supplies are given from the national grid, the Electricity Commissioners can impose a relationship between price and dividend (1926 Act, Section 32). Annual accounts have to be kept and made up in a prescribed form and copies must be available for sale.

Something must be said, however, about the electric power companies. There are some 76 special Private Acts of Parliament which are special Acts within the Electric Lighting (Clauses) Act, 1899, relating to this class of undertaking and they have this peculiarity: the maximum prices chargeable and the maximum dividend payable by the company are fixed subject to a sliding scale. A power company is incorporated almost always by the Act which creates it. Prices are fixed also by the Act, subject to periodical revision by the Ministry of Transport; the revision period is generally ten years and the dividend payable is limited (generally) to 8 per cent. on the following slide:—

For every $1\frac{1}{4}$ per cent. by which the prices actually charged by

the company throughout their area in any year are below the maximum prices fixed by the Act, the dividend may be increased by 5s. per cent., and for every 5s. per cent. by which the dividend in any year exceeds the rate of dividend fixed by the Act, the prices charged by the company for the next year must be $1\frac{1}{4}$ per cent. below the maximum prices fixed by the Act. The company may make good any deficiency in any previous dividend.

Special legislation has been passed to deal with the companies supplying electricity in the County of London. Rights to purchase these undertakings were given up in 1925 by agreement with the local authorities and the companies undertakings were left to them until 1971. Meanwhile, they were granted standard prices based on the then existing costs and dividends by the London Electricity Acts, Nos. 1 and 2, of 1925, subject to the revision of these prices in 1931 when the dividends were to be reduced. These standard prices were divided into four categories of supplies, viz. :—

- (1) Railway and traction.
- (2) Bulk.
- (3) Street lighting.
- (4) Private consumers.

and, within each of these sections, the company was to share in the excess profits for augmentation of dividend, the remainder of any economies or any increasing profits being applied to the reduction in price subject to the right to create limited reserves. From 1925 onwards the companies were to set aside sinking funds for the redemption of capital, calculated so that in 1971 the whole of the undertaking will pass to the London and Home Counties Joint Electricity Authority, the same authority having to pay for stocks, stores and debts taken over, and a further sum for assets acquired during the latter part of the term not fully provided for by the sinking fund. In this way the company would be repaid the whole of their capital then outstanding.

The companies were required to issue new capital in the most advantageous form and on the best terms obtainable. They were prohibited also from paying back dividends and were allowed to set up a contingency fund not exceeding $\frac{1}{2}$ per cent. per annum on the

capital outstanding as a charge with a further optional $\frac{1}{2}$ per cent. payable out of divisible profits. Standard prices are subject to revision at any time at intervals of three years if special circumstances then ruling justify such revision.

The general position of the supply of electricity has been considerably modified by the Electricity (Supply) Act, 1926, under which a Central Electricity Board was constituted, charged with the duty of supplying electricity to authorised undertakers. The Board have to prepare schemes relating to specified areas, determining generating stations to be selected at which electricity shall be generated for the purposes of the Board, and also for providing main transmission lines. They have power to determine tariffs for electricity supplied directly by the Board to authorised undertakers with a limitation of price governed by the cost which the owners of existing stations would have incurred, had the Act not been passed, in themselves generating the like quantity of electricity.

They have also power to alter the frequency employed so as to effect a standardisation of frequency with a repayment of the cost to the authorised undertaking for any expenses incurred in carrying such requirements into effect, and for such expenses the Board have power to borrow money to be repaid by the Electricity Commissioners, and the sums required to meet interest, together with the sinking fund in respect of money borrowed for this purpose, the Commissioners, in their turn, have the right to recover from the industry.

The Act gave the Board the power to borrow for their general capital expenditure the sum of £33,500,000 and to capitalise the interest for five years with power to the Treasury to guarantee the loans to the Board. Under the same Act, where any company, being an authorised undertaking and not a power company, receive a supply of electricity from the Board, the Electricity Commissioners may, having regard to any change in the cost of electricity attributable to the Act, by a special order, make provision as to the relation between the charges to be made for electricity and the dividends to be paid by the company. This is a very important provision and may control profits to an extent not previously possible. From this provision the London companies are excluded.

The Act deals also with the question of compulsory purchase of undertakings in future orders and authorises the institution of two-part tariffs and the prices to be charged for the sale of fittings ; but I have said enough in this respect to cover, generally, the control and limitations placed on undertakers by this particular Act.

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TRAMWAYS

Tramways are governed by the Tramways Act of 1870 and are authorised whether in the hands of a public authority or a company. Under this Act the Board of Trade, and now the Ministry of Transport, have power to grant orders to a local authority, or a company with the consent of the local authority, for the construction of a tramway subject to the approval of Parliament. They have power also to revoke or extend any provisional order. Of course, such an undertaking may be authorised by Private Act of Parliament. The Act contains powers with regard to the purchase of an undertaking by a local authority after a period of 21 years and promoters were, thereupon, bound to sell the undertaking upon the terms of the then value (exclusive of any allowance for past or future profits or any compensation for compulsory sale) all the tramway, all lands, buildings, works and plant suitable to and used by them for purposes of their undertaking. The tolls are fixed by the Special Act or Order as maxima. The revision of tramway fares and stages is governed by the Tramways (Temporary Increase of Charges) Act, 1920, which is still in force, the determination of these matters being in the hands of the Ministry of Transport.

DOCKS AND HARBOURS

As an illustration of this class of undertaking and its extent I may cite the Port of London Authority. The Port of London Authority are a public board formed to acquire in 1909 the undertakings of the three London Dock Companies at an initial cost of some £22,000,000. Their total capital issues, including stocks and other obligations, are now, approximately, £40,000,000. The authority consist of 29 members, 18 elected and 10 appointed by various interests, and a Chairman. Their powers of charge are regulated by a number of Acts and their revenues have to be applied in payment of their working expenses, interest on stock and loans and

sinking funds and to a reserve fund not to exceed £2,000,000. There are various other funds.

As regards their powers of charge, these relate to four matters, being their main sources of revenue :—

- (1) Port Rates on goods,
- (2) River duties on tonnage and tolls,
- (3) Rates for services to goods,
- (4) Rates on vessels using the docks.

(1) As regards the port rates, these are specified in their 1932 Act and are maximum rates subject to revision downwards by the Minister of Transport upon application to him. Within the maxima, the authority can vary the rates, subject to one provision under their 1920 Act, under which port rates charged on goods exported to parts beyond the seas must not exceed one-half of the port rates for the time being actually charged on similar goods imported from parts beyond the seas, and the port rates on goods imported coastwise must not exceed one-half of the port rates for the time being actually charged on similar goods imported from parts beyond the seas ; the port rates on goods exported coastwise must not exceed one-half the port rates for the time being actually charged on similar goods either imported coastwise or exported to parts beyond the seas, whichever rate may be the lower.

The provisions as regards goods imported and exported coastwise do not apply to coal, patent fuel, coke, &c., in respect of which the port rates on exports coastwise must not exceed one-half of the port rates for the time being actually charged on these goods, respectively, imported coastwise.

(2) River duties of tonnage and tolls.—These are maximum charges.

(3) Rates for service to goods.

The authority have power to take rates on, practically, every service which can be rendered by them without a maxima (except as regards a landing rate which applies to imports), such as craneage, piling, housing, weighing, coopering, sampling, &c. These rates must be only such reasonable rates as the port authority shall, from time to time, appoint and no question of any maxima in re-

spect of these services arises. Maximum charges, however, are laid down in respect of the landing rate, which applies to imports; wharfage and portorage rates, which apply to exports. Here again, the maximum rates are subject to revision by the Minister of Transport.

(4) Rates on vessels using the docks.

These rates are laid down under the 1923 Act with provisions as regards revision by the Minister of Transport. Charges for rents of lands and premises and rents paid by shipowners for fixed berths are not subject to any control. There are certain other charges which are not controlled by Statute.

There are a number of other Boards or River Commissions dealing with the various ports around the coast. Their charges are all regulated by their own Special Acts, but are subject to amendment under the Harbour and Docks (Temporary Increase of Charges) Act, 1920, which Act had a limited life, but has been continued from time to time by Expiring Laws Continuance Acts.

THE LONDON PASSENGER TRANSPORT ACT

The year 1933 has seen the passing of the above Act which will create a new Board to take over the Underground Railways in London, the omnibuses, tramways and certain other transport interests, and also the powers to run steamboats on the Thames transferred from the London County Council. The Act provides also for the pooling of receipts in the suburban area with the main line railways. Incidentally, it is of considerable interest to find that the Bill contains provision whereby five appointing trustees are enumerated whose duty it will be to appoint members of the new Board who will control the operations of this very important group of undertakings. Of these appointing trustees one is the President of the Institute of Chartered Accountants. The activities of the new Board are subject to control in many particulars by the Ministry of Transport.

The primary object of the Board is to co-ordinate passenger transport within the London Transport Area (extending some considerable distance outside London proper) and with directions to

fix such fares and charges so as to secure that their revenues shall be sufficient to defray all their revenue charges. The existing statutory provisions as to charging powers are to have effect and the power of the Minister to revise tramway fares is to cease, but no goods or animals may be carried on any road vehicle. Fares in force on the date of transfer of the undertakings are to be scheduled and deposited at the Ministry and to be open for inspection. Revision of fares may be made by the Railway Rates Tribunal on the application of any local authority or the Board so as to increase or reduce the fares, but 12 months must elapse between any general revision unless there has been a material change of circumstances, and this extends to main line suburban fares.

With regard to alterations of services or facilities, or new services or facilities which may be contemplated, there are provisions safeguarding the financial position of the Board or the main line railways in the hands of the Rates Tribunal, and these extend to the fixing of fares and the provision or withdrawal of services.

The existing capital powers of the present railway companies are transferred to the Board with further powers to borrow ten million pounds. The Board are to establish a Reserve Fund and an Insurance Fund. Sinking funds for the Tramway Debt liquidation and a general sinking fund for the redemption of debt within a ninety-year period are also constituted.

An annual report in a form to be prescribed by the Minister is to be made and also such financial and statistical returns furnished as may be determined, and also annual accounts are to be prepared in a form to be prescribed and such accounts are to be audited.

The Act provides for the payment of interest on the various capital stocks of the Board at fixed rates in order of priority. The last stock is designated "C" stock which has a standard rate of dividend of 5 per cent. for two years and thereafter at $5\frac{1}{2}$ per cent. and in such later period further interest out of available revenues. If such additional interest is not distributed, it is to be paid into a special fund called "'C' Stock Interest Fund" and moneys may be withdrawn from that fund to pay interest up to a maximum rate of 6 per cent.

The Act contains elaborate provisions as to settlement of disputes as to pay and conditions of service through a Wages Board and Negotiating Committee and by the establishment of Councils on which employees are represented.

This Act contains many other provisions which I have not attempted to deal with. There are some hundred or more Sections and sixteen Schedules. Those I have mentioned I have compressed very much, but it seemed to me, that this, the latest Act of Parliament to deal with Public Utility Undertakings, was of sufficient importance to merit consideration in this paper, even if my effort may be said to be somewhat sketchy and wanting in detail.

ROAD TRANSPORT BILL

Whilst this paper was in course of preparation, the Government have announced their intention to introduce into Parliament a Bill for the control of Road Transport and, apparently, this will deal both with the licensing of vehicles used for the conveyance of goods, regulating charges and hours of work, the intention, no doubt, being to exercise control over this class of business particularly with relation to the competition at present existing with the railways.

Summing up the whole question of control of public utilities, two main facts emerge—First, that all these matters are designed for the protection of the public although, at the same time, they are drawn also to protect the interests of the investor in the various enterprises by giving him a reasonable return on the capital invested. Secondly, it will be seen how very considerable are the powers vested in the various Government departments. There are people who object to what is termed bureaucratic control but, speaking generally, this control can be only exercised with safeguards by means of representations which can be made to the departments concerned when questions of revision of charges or profits arise and, if such questions are raised by the undertakers, there is, in many cases, the ultimate authority and control by Parliament itself for the protection of the public. The principal departments with whom these matters rest are :—

The Board of Trade.

The Ministry of Health.

The Ministry of Transport.

The Electricity Commissioners.

The Railway Rates Tribunal.

In conclusion, I can hope only that I have introduced to you a subject which, while it may not be familiar to all accountants, is, as I suggest to you, nevertheless, of practical interest to all citizens.

STATUTES CITED

- Railway and Canal Traffic Act, 1854.
 Regulation of the Forces Act, 1871.
 Regulation of Railways Act, 1873.
 Railway and Canal Traffic Act, 1888.
 Railway and Canal Traffic Act, 1894.
 Railway Companies (Accounts and Returns) Act, 1911.
 Railways Act, 1921.
 The Companies Clauses Consolidation Act, 1845.
 The Waterworks Clauses Act, 1847.
 The Waterworks Clauses Act, 1863.
 The Statutory Undertakers (Temporary Increase of Charges) Act, 1918.
 (This Act has expired.)
 The Water Undertakings (Modification of Charges) Act, 1921.
 The Gas Works Clauses Act, 1847.
 The Gas Works Clauses Act, 1863.
 The Gas Works Clauses Act, 1871.
 The Gas and Waterworks Facilities Act, 1870.
 The Gas and Waterworks Facilities (Amendment) Act, 1873.
 The Gas Regulations Act, 1920.
 The Gas Undertakings Act, 1929.
 Electric Lighting Act, 1882.
 Electric Lighting Act, 1888.
 Electric Lighting (Clauses) Act, 1899.
 Electricity (Supply) Act, 1926.
 London Electricity Act No. 1 and No. 2, 1925.
 The Tramways Act, 1870.
 The Tramways (Temporary Increase of Charges) Act, 1920.
 Metropolis Water Act, 1902.
 Metropolitan Water Board (Charges) Act, 1907.
 Metropolitan Water Board (Charges) Act, 1921.
 The Port of London Authority Act, 1908 and subsequent Acts of 1920,
 1923 and 1932.
 Harbour and Docks (Temporary Increase of Charges) Act, 1920.

APPENDIX A

RAILWAYS ACT, 1921

ADJUSTMENT OF CHARGES TO REVENUE

Adjustment of powers of charging to revenue

Section 58.—(1) The charges to be fixed in the first instance for each amalgamated company shall be such as will, together with the other sources of revenue, in the opinion of the rates tribunal, so far as practicable yield, with efficient and economical working and management, an annual net revenue (hereinafter referred to as the standard revenue) equivalent to the aggregate net revenues in the year nineteen hundred and thirteen of the constituent companies and the subsidiary companies absorbed by the amalgamated company, together with—

- (a) a sum equal to 5 per cent. on capital expenditure forming the basis on which interest was allowed at the end of the period during which the constituent companies and subsidiary companies were in the possession of the Government ; and
- (b) such allowance as may be necessary to remunerate adequately any additional capital which may have been raised or provided in respect of expenditure on capital account incurred since the first day of January, nineteen hundred and thirteen, and not included in the expenditure referred to in the last preceding paragraph, unless it can be shown that such expenditure has not enhanced the value of the undertaking ; and
- (c) such allowance as appears to the rates tribunal to be reasonable in respect of capital expenditure (not being less than twenty-five thousand pounds in the case of any work, and not being capital expenditure included in paragraph (a)), on works which enhance the value of the undertaking, but which had not at the beginning of the year nineteen hundred and thirteen become fully remunerative :

Provided that, in determining the sum which charges will, with efficient

and economic working and management, yield, the tribunal shall, with a view to encouraging the taking of early steps for effecting economies in working and management expenses rendered possible by or in anticipation of amalgamation, take into consideration the economies effected by such steps already taken, and shall make such allowance in respect thereof as the tribunal may consider fair and equitable to an amount not exceeding thirty-three and one-third per cent. of such economies.

(2) The tribunal when fixing charges in pursuance of the provisions of this section shall have regard to the means which in their opinion are best calculated to ensure the maximum development and extension in the public interest of the carriage by railway of merchandise and of passengers and their luggage, and shall accordingly ascertain as far as may be practicable the effect which the existing charges, or any of them, have had upon the merchandise or passenger traffic to which they are applicable, and in particular whether the application of such charges has tended or, if continued, would be likely to tend towards causing the increase or diminution of the said traffic.

(3) If on any such review as is mentioned in the next following section it appears to the rates tribunal that the allowance made under paragraph (c) of subsection (1) of this section was too high or too low, the tribunal may revise the allowance and make such adjustment in the amount of the standard revenue as may be necessary.

(4) When fixing the charges necessary to produce the standard revenue, the tribunal shall take into consideration the charges in respect of any business carried on by the company ancillary or subsidiary to its railways, the charges for which are not subject to the jurisdiction of the tribunal, and if in the opinion of the tribunal the company is not making, or has not taken reasonable steps to enable it to make, adequate charges in respect of any such business, the tribunal shall, in fixing the charges under this Part of this Act, take into account the revenue which would be produced by any such business if adequate charges were in operation.

Periodical review of standard charges and exceptional rates

Section 59.—(1) The rates tribunal shall review the standard charges and exceptional charges of each amalgamated company at the end of the first complete financial year after the appointed day, or, if the appointed day is the first day of January in any year, at the end of that year, and, unless directions are given by the Minister to the contrary in manner hereinafter appearing, at the end of each succeeding year, and the review



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shall be made on the experience of the operation of those charges for the period during which the standard charges have been in operation, or, if that period is more than three years, then on the experience of the operation of those charges during the preceding three years.

(2) The Minister may direct as respects any year after the second annual review that a review shall not be held, and the directions may extend either to all the amalgamated companies or to any one or more of those companies :

Provided that no such direction shall extend to any company which has applied to the Minister for a review, or in respect of which the Board of Trade on the application of any representative body of traders have requested that a review shall be held.

(3) If on any such review the rates tribunal find that the net revenue or the average annual net revenue obtained, or which could, with efficient and economic management, have been obtained, by the company during the period on the experience of which the review is based is substantially in excess of the standard revenue of the company, with such allowance (if any) as appears to the tribunal necessary to remunerate adequately any additional capital which may have been raised or provided in respect of expenditure on capital account incurred since the date upon which the standard charges were fixed in the first instance, the tribunal shall, unless they are of opinion that owing to change in circumstances the excess is not likely to continue, modify all or any of the standard charges and make a corresponding general modification of the exceptional charges of the company so as to effect a reduction of the net revenue of the company in subsequent years to an extent equivalent to eighty per cent. of such excess:

Provided that the tribunal in making such modifications as aforesaid as respects one amalgamated company shall, so far as practicable, avoid making such modifications as would be likely to affect prejudicially the financial position of any other railway company.

(4) If on any such review the rates tribunal find that the net revenue or the average annual net revenue obtained by the company during the period on the experience of which the review is based is less than the standard revenue of the company, with such allowance (if any) as appears to the tribunal necessary to remunerate adequately any additional capital which may have been raised or provided in respect of expenditure on capital account incurred since the date upon which the standard charges were fixed in the first instance, and that the deficiency is not due to lack of efficiency or economy in the management, the tribunal shall, unless in

their opinion owing to change of circumstances the deficiency is not likely to continue, make such modifications in all or any of the standard charges and such a corresponding general modification of the exceptional charges of the company as they may think necessary to enable the company to earn the standard revenue with such allowance (if any) as aforesaid.

(5) Whenever on any such review such an excess as aforesaid is found then, for the purposes of subsequent reviews, subsection (3) of this section shall have effect as if for the standard revenue there were substituted a sum (hereinafter referred to as the "increased standard") equal to the standard revenue with the addition of twenty per cent. of such excess, and whenever on any such subsequent review an excess is found above the increased standard together with the allowance (if any) for additional capital, then, for the purpose of subsequent reviews, the increased standard shall be increased by a sum equal to twenty per cent. of such excess, and so on :

Provided that, if at any time after such an excess has been found, the standard charges and exceptional charges are modified in pursuance of subsection (4) of this section on account of a deficiency, no such substitution shall be made until an excess above the standard revenue together with the allowance (if any) for additional capital is again found.

(6) The rates tribunal, when modifying charges on any such review, shall have regard to the like considerations as when fixing charges in the first instance :

Provided that the tribunal shall have regard to the financial results obtained from the operation of any ancillary or subsidiary business carried on by the company, and if satisfied that the net revenue resulting therefrom is, having regard to all the circumstances, unduly low, may, for the purpose of such review, make such deductions from the charges which would otherwise have been fixed as they think proper.

(7) The modifications of standard charges and exceptional charges made in pursuance of this section shall take effect as from the first day of July in the year following the last year under review or such other date as the rates tribunal may fix.

DISCUSSION

THE CHAIRMAN : The Congress resumes this morning to consider a paper submitted by Mr. Cash which is of the greatest importance to every part of the world, no matter from which country you come. It is the question of the control of public utilities. In this old country we have two methods of control ; and I am sure you have followed carefully in the paper the method of a public utility company as against a municipal control of the social services.

We are eminently satisfied in having Mr. Cash to deal with this subject because no one is better qualified to put the whole issue before the Congress. In this country we have associations of the different public utilities, and Mr. Cash is the immediate Past-President of the British Waterworks Association and is President during the current year of the British Commercial Gas Association.

You all know his connection with this Congress. He was at Amsterdam and took a prominent part in that Congress. Then he was in America and submitted a paper there. Then, as you know, in his professional life he has a connection in audit and administration and as an expert witness with the subject with which he will deal this morning.

I now have great pleasure in calling upon Mr. Cash to introduce his paper. (Applause.)

MR. WILLIAM CASH, F.C.A. : Mr. Chairman, ladies and gentlemen, I am much obliged to our chairman for the very kind remarks and the very flattering references he has made to me, and I appreciate very much the honour of being allowed to address you on this subject. I am also glad to have the opportunity of meeting again certain friends whom I met in Amsterdam and in New York.

The paper is in your hands, and following our usual practice here I am only going to say a few words in introducing it to you. It is not necessary for me to go over it in detail. I just want to make this point, that it deals with the British position, and I hope some of our foreign friends will have an opportunity of telling us what the practice is in their countries. There are regulations in those foreign countries, as for example, in the Argentine

where English companies carry on railway, water, gas and harbour businesses, which I have not attempted to deal with.

Then I would emphasise the fact that statutory undertakings are what I would describe as quasi-monopolies operating in defined areas but not free really from competition to-day except possibly in the case of the water companies. The competition, as you will readily appreciate, with regard to railways lies between railways and roads. Gas and electricity are in competition every day, and even the tramways have to compete with motor buses.

Here in London—we are talking in London—the amount of capital involved in these undertakings is very considerable. If I take, for example, the Metropolitan Water Board, which is a body constituted by Act of Parliament, it supplies a population of over 7,000,000 people, covering an area of 573 square miles ; with 1,300,000 different connections, and with a capital of £53,500,000.

Then there is the Port of London Authority, another important body set up by Act of Parliament and controlled as to charges and profits, which has a capital of over £41,000,000.

Then three Metropolitan Gas Companies, which extend beyond London, have a capital—the three of them—of £55,500,000. There are fourteen electricity companies which operate in London, and extend beyond London, which have a capital of £50,000,000. So that those four groups between them have a capital of over £200,000,000.

Then (and this is, perhaps, rather appropriate because it is a matter which has only just come into being) we have the London Passenger Transport Board which will control the underground lines, the buses, and have the right to carry passengers on the River Thames. It is estimated that its capital, when the whole transfer has been completed, will amount to £120,000,000. Adding that to the other figure, you get a total capital involved of £320,000,000.

Part of my paper deals with the railway position, and, as you probably know, the total railway nominal capital in this country is about £1,300,000,000. Now, accountants I suggest to you are interested in this subject in various capacities, as auditors of these undertakings, as experts when they are dealing with the constitution of the businesses, or the revision of their charges, and also of course in the form of the accounts which in many cases are laid down by statute. Most of these undertakings are constituted under special Acts of Parliament ; but they are administered so far as their ordinary business is concerned under the Companies

(Clauses) Act, 1845, an Act with which all accountants are not very familiar.

On the question of control, I would remind you, as I say in the paper, that it is two-fold. First, as regards charges, and, second, as regards profits and/or dividends, these being, of course, in many cases interlocked.

In the Railways Act of 1921 a new provision was inserted with regard to railways under which a proportion of economies and good management was to be shared with the traders. Of course you all know quite well that to-day that clause is inoperative because of the position of the railways.

Water surplus profits after limited reserves are applied for the benefit of consumers in reduction of prices and charges ; and similar arrangements are in operation with regard to gas undertakings where, in addition, a sliding-scale system has been introduced under which the proprietors are entitled when profits permit to increased dividends. In some of these cases in latter years the consumer, the shareholder, and the workman have been joined together in one common interest whereby even the work-people are entitled to a share of the surplus profits when these are available. That principle of the sliding scale has also now been introduced into certain of the Electricity Acts, and particularly in the 1925 London Electricity Act which applies to the companies operating in London.

Now, the main principle underlying the whole of these arrangements for controlling profits and dividends is what has been termed, and is well known in the railway world, as undue preference, which is not allowed. In other words, all those interested in the operations of the undertaking have to be treated alike ; and similar provisions apply in the case of the gas and water undertakings where consumers must be treated alike under similar circumstances. The other principle which has been applied in these Private Acts is that there is protection for capital, and if abnormal circumstances arise either in favour or against the undertaking there are provisions for revision of the charges.

On the question of revision, I have told you, if you will refer to the end of the paper to page 216, the Governmental departments which are concerned to watch these undertakings, and who also have to act in a judicial capacity with regard to charges. They are the Board of Trade, the Ministry of Health, the Ministry of Transport, the Electricity Commissioners, and the Railway Rates Tribunal.

There is one little matter which is of interest to us as accountants, and which is peculiar in this sense, that in the constitution of the London Passenger Transport Board the appointments to that board of the direc-

tors and managers are made by a number of trustees, and of those trustees—you will see this on page 214—one is the President of the Institute of Chartered Accountants, a compliment paid to our profession of substantial interest.

In the case of the London Passenger Transport Board, arrangements with regard to capital are that the ultimate C stock is to carry a dividend of 5 per cent. if earned for the first two years, increased thereafter to 5½ per cent. and with a maximum thereafter of 6 per cent.

While we are talking of matters which are, perhaps, rather prominent to-day you will see that I have referred on page 216 to the Road Transport Bill which is actually being considered in Parliament this very week ; and in that connection it is important to realise the object of that Bill. The position, as we all know so well of the railway companies, is to-day somewhat serious. If I take together the London, Midland & Scottish and the London & North Eastern Railway Companies, there is £173,000,000 of ordinary stock receiving no remuneration ; £280,000,000 of prior charges receiving no remuneration, and a further £181,000,000 of prior charges in respect of which the full dividend has not been paid.

With regard to the Road Transport Bill, an interesting case has recently been decided of *Robinson & Co. v. The Great Western Railway Co.*, where the railway proposed a flat rate for one trader to include a large number of stations, and this was turned down by the Railway Rates Tribunal on the ground that it was contrary to the provisions with regard to undue preference, and also that the conveyance charge was not ascertainable. The Bill provides for similar rates being quoted in future, but reserves the position of the traders so that they can by representative bodies make objections. The fear of the small trader, of course, exists ; but the road powers to-day are uncontrolled, and you have the peculiar position that a road carrier can refuse traffic if he does not like the class of traffic, whereas the railway company has to accept all the traffic that is offered to it.

Turning back again to the London Passenger Transport Board, it is rather interesting to observe what I think has appeared in most of the daily newspapers, that this undertaking will control over 11,000 passenger-carrying vehicles. 3,000 of those are on the Underground Railways ; there are over 5,000 buses and coaches, and 2,600 tramway cars, and the number of passengers carried in 1932 reached the enormous total of 3,463,000,000. So that you have there a new body of a very important character.

I do not think I need take up any more of your time, ladies and gentlemen.

May I now leave the paper in your hands, and I shall listen with pleasure to any observations that will be made.

I understand my friend Mr. Arthur Collins, whom I have met on a good many occasions under various circumstances, and who is particularly qualified to deal with this question perhaps from rather a different angle, is going to say a few words to you, and his experience is such that I am sure you will all listen to what he has to say with the greatest of pleasure. (Applause.)

THE CHAIRMAN : I will now call upon Mr. Collins to open the discussion.

MR. ARTHUR COLLINS, F.S.A.A. (Great Britain) : Mr. Chairman, ladies and gentlemen, in an American magazine published under the auspices of a university there appeared a review of a book closely related to the subject of this paper. The said review was headed "Modern Monopoly as the Gentleman Crook," and the title of the book under review was "The Masquerade of Monopoly." It consisted mainly of an exposure of the devices by which the American public is said to be exploited by the management of public utility services in the hands of private corporations, or as we should say, private companies. It forms a piquant introduction to the discussion of this subject, and certainly lights up the phraseology we generally employ on so prosaic a subject as statutory undertakings.

A great deal depends upon the way the public look on undertakings with a monopoly of the article or service they supply. If by general consent the service is one which should either be in public hands, or if not, should be placed beyond exploitation in the pernicious sense, the degree of the control of the service in the hands of a company, or of anybody except the public representatives, is likely to be extensive and strict. If, however, the business is one which it is thought by the public should more appropriately be entrusted to private enterprise, then anything reasonable and broadminded in the form of safeguards against exploitation of the public meets the case. In Great Britain, water supply comes within the former category, and railways in the latter, speaking quite broadly.

It follows that the control of charges and profits of statutory undertakings is exercised in a variety of ways, differing in each country, and in respect of each undertaking, according to its nature and to the attitude of mind of the public towards it.

The accountancy profession, particularly those members of it who

specialise in public utility accounts, is entrusted with a heavy responsibility as the servants of the public in connection with monopolies like gas, electricity, or water. If they act for the operating company, they have to keep in mind not only the need for correct accounts, but the assistance they can render the directors in maintaining a fair balance between charges and profits. If they serve the local councils as officials or advisers, looking at these accounts from the point of view of the public, as consumers, they have to discharge the duty of criticising, constructively wherever possible, the charges of the company, without damage to the reputation and standing of the company when it comes to raise capital for the development of the business.

It is common ground that whether the monopoly supply be furnished by a public body or by private enterprise, the following conditions should be met :—

- (a) The proprietors should not be at liberty to pick and choose their customers, but that with the right of supply there should be the obligation to give service upon reasonable terms and conditions. All consumers in the like circumstances must be charged the same prices.
- (b) That the prices charged for the services rendered should be sufficient to ensure a reasonable return upon the capital employed.
- (c) That what is a reasonable return must depend upon the circumstances of each case, as this is not capable of standardisation either for all concerns of one character or for public utility businesses of a different nature operating in the same district.
- (d) That maximum prices shall be fixed for all supplies, either comprehensively or in categories, or if there be no maximum price fixed, that a maximum or limit should be placed upon the dividends payable on capital, such limit being settled in many cases, in relation to prices charged, so that by a sliding scale the dividend may rise as the prices are reduced, and *vice versa*.

It is only upon such general forms of restraint upon improper trading that the proprietors are confirmed in their possession of the monopoly and protected from competition wholly or partly. Absolute protection, even with the most stringent safeguards of the public rights, is practically almost impossible. Railways are controlled in their charges and profits to-day more by the competition of road transport than by statute. Tramways or street cars are in the same position in competition with the motor bus and private motor vehicle. Gas prices are restrained, and dividends kept

in many cases well below the authorised dividends, by the introduction of the use of electricity. The charges for electricity must also be attractive to compete with gas, or, in rural districts, with more primitive forms of lighting and heating. Very few electricity undertakings are to-day charging the maximum prices permitted to them by the law governing their operations. There is as yet no effective substitute for water, so that in this case the check upon prices and safeguards against excessive dividends have to be provided by legislation.

Moreover, the trend of public opinion in this country has been towards public ownership of monopoly businesses like gas, water, electricity, and transport. Long ago the Acts of Parliament by which gas and water concerns became statutory undertakings did not contain provisions conferring the rights of purchase upon the local authority of the district served, after the exercise of the franchise by the company over a course of years. Electricity undertakings and tramway concerns, provided by private enterprise, are nearly all subject to rights of purchase on behalf of the public in course of time. Rights of purchase are frequently given by Parliament where a company providing a public utility service has not been able to show a good record, after operating some years. Control of charges and profits by the scrutiny of accounts and by the use of Parliamentary restrictions is not the only effective method open to the public. The fear of the local authority exercising its rights of purchase of the undertaking is commonly a strong inducement to the private company to keep the charges and dividends down to a level which the local authority itself might not be able to maintain, if it superseded the operating company.

It is beyond doubt that great difficulty is experienced by the National Government of any country in framing and adjusting from time to time the measures by which a fair balance is to be maintained between the interests of the consumers and the interests of the shareholders of a monopoly business in private hands. In Great Britain the provisions of Parliament applicable to private trading in these monopolies are to be found partly in the general law and partly in what we call private legislation applicable to a particular undertaking. It is really necessary to proceed, as Mr. Cash does, by way of historical review, to perceive how the various methods of control have been imposed upon railways, water, gas, electricity, tramways and similar undertakings.

Different legislation applies to each class of concern, in so far as the general law deals with them, and extensive as that general legislation is,

it is supplemented to a great extent by the contents of Acts of Parliament promoted by the proprietors of the undertakings seeking to clothe themselves with Parliamentary powers for the purposes of their business.

No review of the British provisions for keeping in check the prices charged and the dividends paid by private monopolistic undertakings would be complete if it did not draw attention to the great value of Private Bill procedure. On the face of it, it would seem to be the case that the promotion of a Private Bill for the consideration of Parliament would enhance only the interests of the proprietors. In fact the promotion of the Bill presents the opportunity to the members of the local councils, who represent the interests of the consumers, to ask for the approval of Parliament to stronger and more effective powers of control over the enterprise and operations of the proprietors of the private undertaking, where experience shows they are needed.

In the long run, whether by general or local legislation, it is the British practice to provide for the following essentials, namely :—the rights of consumers to have a supply on reasonable terms ; a reasonable dividend upon capital employed ; a maximum dividend or a sliding scale dividend related to prices ; and general recognition of the fact that there is an element of trust, as well as commercial enterprise, in the conduct of a business protected from competition by another company or public body in the same industry in the same vicinity.

It will generally be agreed that in this country we have managed to avoid violent controversy as to the sufficiency or otherwise of measures in the public interest designed to control prices and dividends of monopoly concerns like those dealt with in Mr. Cash's paper. Our long traditions of public service, both by local elected councils and by public utility companies, have much to do with this state of public feeling.

It is a fortunate circumstance that in this country we have not been involved in strife about the amount of capital which is to be taken for the basis of the calculation of dividends. We have fairly clear ideas of what is an appropriate rate of interest upon capital employed. We invariably take the capital actually invested in the concern, subject neither to appreciation nor depreciation, and the average rate of dividend thought to be reasonable has a fairly close relationship with the return for the time being obtainable on investments in Government securities. It must always be true of all these monopoly businesses that although technically services like railways and transport generally can charge "what the traffic will bear," there is a point of exhaustion which the proprietors

must not pass for fear they lose their customers. It is as much in the interests of the proprietors as of the consumers that there should be goodwill and respect between customers and shareholders.

While we have not in this country experienced a period of acute controversy in the matter of charges for gas and electricity, or transport, as in the United States—accentuated, I fear, by the American doctrine of variable values of the capital employed in these businesses—we may observe with considerable interest the movement in that country towards converting consumers into shareholders.

In Great Britain not a great deal has been done in this direction. It may or may not be a good policy for most consumers to be shareholders of local monopoly businesses, but the minorities in any case must be cared for, and on the whole it is considered that the methods we employ in Great Britain for the control of charges and profits of statutory undertakings are based upon reasonable foundations and give general satisfaction.

These observations have been restricted to the control of monopolies, in order to leave full scope to others to deal with the accounting side of the matter.

Moreover, the wide range of this subject, and the length of these notes already, impel me to make but a brief reference to the charges and profits of publicly-owned undertakings. In these cases, "service at cost price" is the maxim favoured by Parliament and adopted by most local councils, though profit making in relief of local rates is, as Mr. Cash's paper shows, not entirely forbidden by law, e.g. on electricity supplies. Where a local council supplies areas outside its jurisdiction for government purposes, the charges made are often controversial, and much could be said for and against differential prices favouring consumers who are responsible as ratepayers to make up trading deficiencies in bad years, against those outside consumers who are not. Although the levy of charges for gas, &c., at profit-making prices, where the area of supply and the area rateable for deficiencies is the same, may appear to amount to more than "change for sixpence," or transferring money from one pocket to another, there is considerable difference in the incidence of levies upon ratepayers for public expenses like roads, and levies on gas consumers to make profits to devote to road maintenance. But apart from that, Parliamentary Committees are tender towards producers in these hard times, and high charges for power or heat or illumination, or water, add to the costs of production in many cases more than the rate relief from trading profits.

This is a consideration which has influenced the present tendency of Parliamentary opinion in favour of cost price, including actual capital charges, for monopoly supplies by public bodies.

Just a word, in conclusion, on the need of standardised accounts of monopoly concerns in the hands of private companies or public bodies. It would be a great achievement if out of such conferences as this there gradually emerged a plan for the establishment of an international form of accounts for businesses supplying water, gas, electricity, transport, and so on. Perhaps we may one day be able to compare the costs of electricity from water power in Canada, for example, with electricity generated by a company in Europe from coal. At present we should not be sure we were comparing like with like even in testing the cost of water between a public body and a private company in England, using the published accounts for that purpose. It is partly by good accounting that the most economical production is attained, as the technical managers of all public utility undertakings will readily agree, and comparative costs, on uniform analyses, can be made into more powerful servants of the public than they are to-day.

Only a master of his subject like Mr. Cash could condense all the essential information on this subject, from the British standpoint, as well as he has done. I must express my admiration of his paper, for in the matter and the method of treatment it is excellent. (Applause.)

MR. J. C. SPANGENBERG (Holland) : My Lord Chairman, ladies and gentlemen, it is with much interest that I have read the paper composed by Mr. William Cash.

Owing to the fact that the esteemed writer expressed the hope that accountants from abroad would also say how similar matters are dealt with in their country, I bring the following facts briefly to your notice. From the paper we have seen there are a great number of Acts in England relating to Public Utility Undertakings. In Holland, on the contrary, there are only a few Acts relating thereto, e.g. the Railway Act, the Tramway Act, and so on. In these Acts all the details of these undertakings have been regulated.

Amongst other things it is enacted that :—

- (1) The rates are fixed by the Government in deliberation with the undertakers ;
- (2) The Government can reduce these rates ;
- (3) The Government warrants a net profit of 4 per cent. on the share capital. If in any year this minimum profit is not earned, the

railway company is entitled to receive the minimum dividend granted, if the railway company can justify its loss which will be controlled by the Government.

If the net profit amounts to more than 4 per cent. out of 9 per cent. of the share capital the shareholders will receive a further $2\frac{1}{2}$ per cent. and the Government the other $2\frac{1}{2}$ per cent. If the net profit is more than 9 per cent. of the share capital, the shareholders will receive only one-fifth of this surplus, while the Government will receive the remaining four-fifths.

- (4) The Government has the right to nationalise the railways ; the Government itself is one of the largest shareholders.

Also for the tramway companies, excluding the one-city tramways, similar regulations have been executed. However, a minimum dividend is not always guaranteed.

Regarding the water, gas, and electricity undertakings as well as the one-city tramway companies, no particular Acts exist.

This is mainly owing to the fact that nearly all such undertakings in Holland are not private companies, but municipal undertakings. Owing thereto, these undertakings are in a more or less monopolised position. I say more or less, because the municipal tramways, for example, have to fight the keen competition of the omnibuses.

On the other hand, some city corporations have made it their business to establish very difficult regulations regarding motor car upkeep : the fitness of chauffeurs, the fares, &c., so that in those cities it becomes very difficult for private enterprise to maintain this competition.

Owing to their monopolised position these municipal undertakings pay as a rule relatively high wages, and therefore they are obliged to charge relatively high rates, and in case of losses the taxpayers finally have to pay for it.

However, there is a further group of undertakings which requires special attention, viz. the Life Insurance Companies. These undertakings have since 1922 been governed by a special Act, " The Life Insurance Act."

Briefly, the purpose of this Act is to regulate the following :—

- (1) To give a sound basis to the confidence of the public, without restricting the freedom of management ;
- (2) To secure as much publicity as possible ;
- (3) The establishment of the Life Insurance Board, which is competent to advise the undertakers with regard to improvement of management, &c.

Such advice may be published, unless the undertakers declare within a fixed time that they will act upon it, or unless they present well-founded complaints against it.

The members, the secretary and the chairman of this life insurance board are appointed by the Government. They may only be interested in any life insurance company in the capacity of insured persons.

- (4) The life insurance companies may only be carried on by limited liability companies or by co-operations. They are not allowed to carry on other business.
- (5) Instructions are given regarding the stipulations which must be inserted in the articles of association of a life insurance company. Amongst these are :—
 - The method of appointment of the directors ;
 - The obligations of the directors in case of loss ;
 - The amount of the owned capital ;
 - &c.
- (6) The life insurance board is always entitled to make inquiries with the companies, and it is not necessary to wait till the annual report has been published ;
- (7) Yearly a number of prescribed uniform statements have to be published, analysing in full the management, the financial position of the company, as well as a specification of the income and expenditure ;
- (8) The life insurance board is entitled to have the books and the documents of any life insurance company examined ;
- (9) Stipulations are given regarding the way in which one company may transfer its contracts to another company ;
- (10) The life insurance board is always entitled on behalf of the company to dismiss the directors and the managers, to appoint other persons or to undertake the management ;
- (11) The life insurance board has to control that in general the investments are of the same value as the premium reserve referred to. It may order a change in the investment policy.

Furthermore, it may indicate the banking firm with which the stocks must be deposited, and order that the stocks must be kept in Holland. If a company refuses to deposit the securities with the indicated bank, the board itself can bring them under its own control. In all, 26 detailed statements have to be published

annually including the balance sheet and the profit and loss account ;

- (12) Finally, the life insurance board may request the Court of Justice to remedy the financial situation of any life insurance company.

Also for the savings bank similar regulations are in force.

(Applause.)

MR. W. B. KEEN, F.C.A. (Great Britain) : Mr. Chairman, my Lord, ladies and gentlemen, Mr. Cash has given us a most interesting and concise summary of the legislation and procedure with regard to these statutory undertakings. His paper is not of a controversial nature, and there are very few points in it to which I need draw your attention or occupy any time about.

The point of interest to me is the question : How far the protection of the public is in fact secured by legislation with regard to these statutory companies ; and in that connection it is perhaps a little useful to consider exactly what the procedure is.

A company desiring to obtain statutory powers promotes a Bill. The Bill is drawn ; it sets out the powers that the company desires to exercise, the charges that they propose they should be authorised to make, the dividends that they should be authorised to pay, the amount of capital they should be authorised to raise, and the general provisions for regulating business. That Bill, after being advertised so that any public interests may petition against it, is submitted to various Government departments to report upon it, particularly in connection with any precedents there may be—because Parliament is always jealous of new precedents being made—and then the Bill, after Second Reading in the House, comes before a Select Committee for consideration. The promoters appear by counsel and witnesses and make their case for the Bill. The opponents are entitled also to appear by counsel and witnesses in opposition.

Now, let us assume that the Bill is (say) a Bill for constituting a statutory gas undertaking, and say that the proposal is that it shall be a sliding-scale company ; or, whether it be a sliding-scale company or otherwise, let us assume, at any rate, that it is a gas company. Assume that under the old procedure prior to more recent years the practice was that a gas company had a maximum price that it might charge, and a maximum dividend that it might pay ; and, in view of those limitations, there was not any very great importance attaching to what the statutory maximum

price was ; it always allowed a margin beyond the price charged at the moment, and the limitation of the dividend was a protection ; but in connection with the settlement of that price accountancy evidence was necessary, and still more necessary if it be a sliding-scale company. Very often the company would put forward very good financial evidence, and the opponents were not sufficiently organised to set up an opposition to adequately criticise or suggest modifications.

Now, ladies and gentlemen, I am sure you will appreciate the fact that (say) the sliding-scale company, being a gas company, shows that the appropriate standard price which is to correspond to a standard dividend shall be X, and assume that they call in support of that proposal Mr. Cash as their financial witness, Parliament will attach great importance to Mr. Cash's evidence. Assuming that the opponents have not thought fit to call an accountant to deal with these matters, or, alternatively, have called an accountant with very little experience to set against Mr. Cash, the chances are that a higher price may be inserted as the standard price than perhaps circumstances would warrant. In fact in such a case as that I would suggest to you that you want not one accountant, but many accountants, to come and challenge Mr. Cash's evidence. The result, therefore, would be that the standard price and the standard dividend are inserted in the Bill, and the Bill duly becomes an Act of Parliament and proceeds upon its course. The company carry out their functions. Their dividend in the first instance, if the state of affairs I have suggested comes about, would probably be slightly in excess of the standard dividend, and they would proceed to a profitable career and increase of dividend. They could proceed up to their maximum dividend and then the directors are embarrassed by the question of what is to be done with the profits. They might like to distribute them among the consumers in the form of a reduction of price, and therefore they have to consider if they have adequate provision for reserves. The idea of companies is to get additional reserves.

I must not proceed on the lines upon which I had hoped to proceed, because time is short ; but I want, at any rate, to proceed to one point which I regard as of some interest and importance in Mr. Cash's paper, and that is with regard to the consumers' benefit. The old sliding scale under which the price was definitely related to the dividend, and under which a penny increase or reduction in the price of gas per thousand feet was followed by a reduction or increase of 5s. per cent. in the dividend on the 10 per cent. shares, was regarded as almost a heaven-sent thing,

and was obviously very satisfactory. That broke down in consequence of the War and the high increase in prices, and the result was that a temporary measure was passed (to which Mr. Cash has referred) under which a reduced dividend was paid—a minimum dividend. Now, after the War the companies hesitated to part with the advantage of the maximum, and I suggest it was in consequence of that that this new system of consumers' benefit was invented. Concurrently with its invention was the invention of the system of charging by therms. I wonder how many of you gentlemen here know what a therm is. A therm is 100,000 B.T.U. What is a B.T.U.? A B.T.U. is the quantity of heat required to raise a pint of water one degree Fahrenheit.

Consumers, finding their gas bills going up, finding they were charged (say) 8d. per therm instead of 3s. 7d. per thousand feet, naturally attributed the increase to therms and they did not like therms very much. They were then told: "You are getting better value for your money." They said: "We do not want better value." To which the company replied: "But you have to have it and pay for it, but you are going to get a consumer's benefit." What is that consumers' benefit? The company are entitled to a calculation: What would have been the revenue derived if they had charged only their standard price, and how does that compare with the revenue they have actually received? The difference is the consumers' benefit, and the company may have one-sixth of that for their dividends. The consumer says: "I have not appreciated any advantage; my charges in many cases have not varied. Where is my share?" The company's reply is: "You have had it." That really is rather like having a cake, cutting it into six parts for yourself and your five children, eating your own share, and trying to persuade your starving family that they have had theirs! It is an ingenious device, and it has come to stay, I suppose, but I think it is very unfortunate that we should not be able to devise adequate protection for the consumers, as well as justice to the shareholders, without something less elaborate; and if any of our foreign friends can suggest equally effective protection without that complication, I think we shall be very grateful to them. (Applause.)

MR. D. M. MUIR, F.S.A.A., F.I.M.T.A.: Mr. Chairman, my Lord President, ladies and gentlemen, in a rash moment the Secretary of the Institute with which I am associated suggested that I might speak on this subject. After hearing the other speakers—Mr. Keen and my friend Mr. Collins—I think there is very little left that I wish to say.

There is one point, however, which I should like to put to Mr. Cash in view of the extraordinary reputation to which Mr. Keen has referred. In Scotland, the country from which I come, water and gas undertakings are almost universally in the hands of the local authorities and not in the hands of private companies. With regard to electricity, they also are local authorities for the greater part; they have control of the supplies, but in many cases where the local authority obtained their Orders or have Private Bills under the Electric Lighting Act of 1899, many of the corporations lease these Acts to private companies. Now, under the provisions of these Acts the local authority has some right to have regard from time to time to the prices charged to consumers in order that the consumers may be protected against overcharging by the companies. I was wondering whether Mr. Cash could suggest to us the proper means by which the local authorities could exercise that control, because it is sometimes found that, whilst the electricity company are exercising their powers under the Electric Lighting Acts, they are at the same time carrying out provisions which they have for the supply of electricity for power purposes; and my experience is that the accounts become so involved as between the costs of distribution of power and the distribution of lighting facilities that it is virtually impossible to arrive at what the proper cost of production and distribution of electricity for lighting purposes is. Perhaps Mr. Cash could give us some indication as to the proper method by which the accounts of these companies should be presented in order that that control which is vested in the local authority may be efficiently carried out. (Applause.)

COUNCILLOR F. WILSON, J.P., F.C.R.A. (Great Britain): Mr. Chairman, my Lord, ladies and gentlemen, statutory undertakings, alternatively termed public utility undertakings, may be defined as those undertakings which provide, under statutory powers granting monopoly or other special privileges, services which are required and are indispensable to all classes of the community. Obviously, this being so, the necessity for control at once arises, for three main reasons: (a) the nature of the service requires that the undertakings shall have special rights, e.g. to open up streets, or to purchase land compulsorily; (b) heavy capital outlay makes the preventing of duplicate provision desirable, resulting in monopoly; (c) a monopoly of services required by all classes of the community necessitates that there shall be some external control.

Now, with regard to methods of control, the most usual in the case of privately-owned undertakings is the maximum dividend and maximum

price method. This protects the consumer from an unduly high charge, but is not sufficiently flexible, especially where the maximum price is fixed not far above the actual price, since an increase in costs, such as that which followed the War, limits profits to an extent which prohibits the payment of reasonable dividends. On the other hand, if this is fixed too high, it enables charges to be made higher than those which would obtain under free competition. The fact that the control is there no doubt obviates its use, as one might instance in the case of the police.

Since the War, various alternatives have been adopted :—

- (a) The standard revenue system applied to railways, which, owing to depression in industry and commerce, they cannot reach.
- (b) The sliding-scale system, applied to gas companies and some electricity undertakings, where a certain rate of dividend is related to a certain price ; a reduction in price permits an increased dividend, and *vice versa*. This system is not ideal, since the “unearned increment” arising from a downward trend in prices enures to the advantage of the stockholder. On the other hand, a rise in costs reduces dividends to an unremunerative level.
- (c) The basic price system, similar to the sliding scale, except that a rise in costs, following increased prices for the service, is not followed by a reduction in dividends, although a reduction in costs increases the amount available in remuneration of capital.

Now, the ideal method of control would provide for a reasonable return on capital, and enable an increased dividend as the reward for efficient management, whilst retaining for the consumer the benefit of a general reduction in costs, and rewarding the employee for increased efficiency. This ideal has yet to be found.

The accounts of public utility undertakings generally follow a standard form, either prescribed by the central authority or agreed by associations representing the class of undertaking. Comparison of all items in the accounts is rendered difficult by differences due to local circumstances, but comparison is possible in the details, and the reason for the differences brought to light.

Costing is essential to enable tariffs to be fixed, but has no direct or final bearing on the question of control of prices. Costings in a tramway undertaking will show which routes pay and which are run at a loss

although the public interest may require the route to be maintained whether profitable or not. Costing divides the cost of producing electricity between fixed charges and running charges, and thus enables suitable tariffs to be devised. The cost of a unit consists of a proportion of the fixed charges plus a proportion of the running charges ; but, since the fixed charge must be borne in any case, it may be profitable to sell current at a figure only slightly higher than the running cost, since any contribution at all towards standing charges increases the net profits.

Finally, I wish Mr. Cash had been able to provide us with some more expeditious and less costly methods of settling differences and disputes between local authorities and privately-owned undertakings. I am fully aware there are many interests involved and to be protected, but, failing local settlements, we proceed to the Board of Trade or the immediate and appropriate department concerned ; then, maybe, to a Select Committee of the House of Lords, and even on to Parliament itself ; and before a settlement is finally arrived at, many weary months have elapsed and oftentimes very great expense involved. Now, if Mr. Cash could devise some more satisfactory methods of dealing with this aspect, he would be rendering and making some definite contribution in the public interest. Of course, I am aware that this would not be a good thing for Parliamentary lawyers, as well as other professional experts, and, if I am permitted to say so, I am not sure that it would be a good thing even for Mr. Cash himself ; but these slow-motion settlements, involving so much time and public expense, might be accelerated with advantage to all parties concerned. (Applause.)

MR. D. W. COATES, C.B.E., M.A., LL.B., F.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, as Mr. Cash said at the commencement, his paper covered a very wide field. That being so, he naturally touched only lightly on any individual concern. It has occurred to me, however, that some further reference to the Electricity (Supply) Act, 1926, which established the Central Electricity Board, may be of general interest, both because of the radical addition which it makes to the structure of the electricity supply industry and because, while adhering in principle to the restriction of prices and profits, the method of applying the principle differs from that which Mr. Cash has described.

The Act, with its schedules, apart from sundry orders and regulations made under it which require to be read with it, runs to fifty or more pages, and any summary in a few words must be rather rough and ready, but,

broadly speaking, the Board's appointed task is to supply wholesale all the electricity required by distributors for sale retail to consumers. For this purpose they have constructed the "Grid" to interconnect the generating stations at which the electricity will be produced and the undertakings to which it is to be transmitted. Interconnection is only practicable given a uniform frequency, and the Act provided, therefore, for the necessary standardisation to be effected.

As Mr. Cash stated, the Board were given by the Act borrowing powers of $33\frac{1}{2}$ million pounds. This amount was increased by special order in 1930 to 50 million pounds, of which roughly 19 million pounds was provided for the cost of standardising frequency.

The Board raise their money by the public issue of fixed interest-bearing stock. In so far as the money is borrowed for the purpose of standardisation of frequency, the interest upon it, and sinking fund contributions for its repayments, are recoverable by the Board from the Electricity Commissioners, who in turn reimburse themselves by means of a levy on the whole electricity supply industry. For the service of the other capital the Board are dependent on their trading operations.

It is not contemplated that the Board will acquire generating stations, but that certain stations, chosen for their efficiency and with due regard to their geographical situation, shall become what are called selected stations, and that, from a date fixed by the Board, each of those stations shall be operated under the Board's directions. After that date the Board take the whole output of the station, paying for it, unless otherwise agreed, at the cost of production.

The Board's costs will thus be the purchase price of the electricity they buy and the cost of managing, operating and maintaining the grid system, including interest and amortisation.

From the date when the Board give notice that they are ready to supply in any area, any authorised undertaker in that area is entitled to demand a bulk supply, and the Board must give it directly or indirectly. The price ordinarily payable for a direct supply is a price in accordance with a tariff fixed by the Board, except that owners of "selected" stations are entitled to buy back electricity which they have generated at the cost of production adjusted to the circumstances of their supply, together with an appropriate proportion of the Board's expenses. If they require electricity which is not available from their own station, they purchase it at the tariff; but they have the overriding protection that they cannot be called upon to pay more for the whole supply than it would have cost

them to produce it at their own station under conditions of independent operation.

If the Board give a supply indirectly, through another undertaker, instead of directly from the grid, the undertaker giving the supply is required by the Act to charge for it on the same terms as are charged to him by the Board plus the cost of transmitting it to the other undertaker, the transmission cost being ascertainable in a manner provided by the Act.

To enable the Board to keep their charges low from the beginning, they are given, subject to consent, the not uncommon power to postpone provision for amortisation. They are also given—again subject to consent—the less common power of charging interest to capital for a time.

But the most important and most novel provision affecting the Board's prices and profits is that their tariff shall be fixed so that, not year by year but over a term of years to be approved by the Electricity Commissioners, the receipts on income account shall be sufficient to cover the expenditure on income account with such margin as the Electricity Commissioners may allow. The Board have fixed their tariff for two areas, and in those areas the period adopted within which the revenue account is calculated to balance is ten years. By adopting such a long period the Board are enabled to fix the tariff low enough to facilitate the expansion of the use of electricity for industrial and domestic purposes, and, as a further means to the same end, the tariffs contain a promotional element, the price payable being progressively reduced as a bulk supply to an undertaker increases, the undertaker's supplies in 1932 being taken as a datum line.

It follows, of course, that in the early years of a tariff period the revenue will be insufficient to meet the outgoings, and that the accounts can be seen in proper light not year by year but only over the tariff decade. This method of budgeting and accounting must take a little time to assimilate, but there is hardly room for doubt that, concurrently with the advantage of reducing the wholesale price of electricity, it will prove more conducive than a seemingly more conservative policy to the Board's financial success.

As Mr. Cash has said, the maximum prices chargeable for electricity are seldom charged. It is, I think, the almost universal experience that each reduction in prices is promptly followed not only by expansion of business but by actually increased profits, and I believe it is recognised throughout the industry not only that the lowest possible prices mean

the maximum performance of duty for a public utility undertaking, but also that they represent the best business policy. (Applause.)

MR. W. APPLETON, F.R.A.N.Z. (New Zealand) : Mr. Chairman, my Lord President, ladies and gentlemen, I am particularly glad to have had the opportunity of being present to listen to Mr. Cash. We in New Zealand follow very largely on the lines of the Old Country with regard to our statutory undertakings, and they are for the most part run by local bodies. We have not so much private enterprise ; New Zealand is more of a socialistic country. Government departments run a good deal of the electricity undertakings, while the various local government bodies run such undertakings as electric lighting and tramways. We have private enterprise in the way of gas companies. Generally speaking, we follow on much the same lines—that is, a fixed dividend maximum of 8 per cent. in the case of gas undertakings, and also the charges are regulated ; but there is one interesting feature in Mr. Cash's paper that we have not adopted, and in which I was very interested, and that is the sliding scale in regard to fixing the lower prices and thus being able to give a higher dividend. That is a principle which I think we might adopt with advantage.

With regard to trading, there is a good deal of trouble in our country by reason of the fact that the gas companies, the private undertakings, have to pay income-tax, whereas a member of the Government or semi-Government institutions, such as lighting bodies, are not charged income-tax ; and the result is that the electric lighting undertakings are free of income-tax, whereas the gas companies have to pay it. That has been a bone of contention.

Another feature has been the fact that a large number of these local government undertakings go in for trading in electrical apparatus. That also has given us some trouble.

In New Zealand, too, in some of the local bodies, we go a little bit further than perhaps you do in England. For instance, in Wellington, where I come from, the local body controls the municipal milk supply ; and there again, we have, of course, statutory charges, and prices are fixed by arrangement with the farmers and the whole thing is done by a Board.

There is one point which occurs to me as the result of the discussion this morning, and that is that when it comes to framing these Bills or getting authority it would be a good idea for the Government, in order to protect the public—and, after all, that is the main feature outside

assuring capital of a fair return—that it should be provided that the auditor is paid by the Government authority. I think that if we did that it would be a protection for the public.

I thank you very much for this opportunity of speaking, and I am very glad to be with you. (Applause.)

MR. F. J. ALBAN, C.B.E., F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, may I be permitted to add my tribute of praise to Mr. William Cash—a Past President of the Institute of Chartered Accountants—for the valuable paper submitted by him to this International Congress.

Each of the undertakings referred to is in fact the subject of many detailed specialist volumes, nevertheless, despite the severe pressure which he has been compelled to exercise owing to limits of space and time, Mr. Cash has been able to present an admirable picture of the methods of control of charges and profits of statutory undertakings which are in vogue in this country. The subject is one which Mr. Cash has made peculiarly his own ; in it he is acknowledged by the accountancy profession in this country to be an expert, as chairman and director of some of our leading water and gas companies, financial adviser, accountant, and witness.

Mr. Cash's paper has necessarily dealt mainly with undertakings under private ownership ; he has indicated the conditions which Parliament has from time to time laid down to ensure that public utility undertakings carried on under private ownership comply with such restrictions as regards management and finance as the public interest dictates in return for the monopoly conferred upon them. Of late years there has been a vast extension of public ownership, or public control, of public utility services, and this under successive and varying Governments—whether Liberal, Labour, Conservative, or National. I refrain from adding to the list or prophesying. Although public control is often loosely called State socialism, there is, of course, a vast difference between the two.

A perusal of Mr. Cash's paper reveals that public control in this country has taken a variety of forms, from simple control to actual ownership, including (1) control without ownership : (a) Control and limitation of charges, profits, dividends, &c., while leaving ownership in the hands of public companies and the like. (2) Control with a view to eventual ownership : (b) Control and limitation of charges, profits, &c., while leaving ownership in the hands of public companies and the like for a period of years, while at the same time, by means of an accumulating

sinking fund provided out of the profits of the undertaking, the monopoly ultimately buys itself out in favour of public ownership (e.g. London electricity). (3) Immediate ownership: (c) Actual ownership by local authorities of undertakings operating within their own areas; (d) Actual ownership by local authorities who supply areas outside their own boundary (e.g. the Manchester water undertaking); (e) Actual ownership by Joint Boards representing a number of local authorities (e.g. the Metropolitan Water Board); (f) Actual ownership by Joint Boards representing a variety of interests, both local authority and commercial (e.g. the new London Passenger Transport Board).

In connection with public ownership, our colleagues from other countries may not realise that in this country we have, in the building up of public utility undertakings under public ownership, to a great extent been the slaves of what I may call parochial boundaries. Because, for example, the urban district council of Z. is the sanitary authority for a particular area, its limited and peculiarly arranged boundaries have, in general, been deemed to be the precise boundaries within which should be exercised the functions of water, gas and electricity supply, and the running of tramways.

Adherence to this fetish of the parochial boundary has led to considerable waste and duplication which is only gradually being put right in the realms of electricity and transport and to a smaller extent as regards water supply. There is probably agreement that, as regards the provision of water supply, this may, in general, best be done by local authorities or joint boards of local authorities; but as regards other public utility undertakings there is room for considerable divergence of opinion.

During the last Parliamentary Session or two, two cases of tramways have come within my personal experience. In one case the local authority was authorised itself to construct and run tramways. Those tramways have become obsolete and are now superseded by electric trolley and petrol omnibuses. While the tramways have gone, the debt remains, and the local authority for some years to come will continue to pay some £5,000 a year out of the rates in respect of interest and sinking fund on a tramway undertaking which is but a memory. No longer is there the jar of the car, but the more subtle jar on the public purse remains.

In the adjoining area, Parliament in its wisdom decided that the construction and running of the tramway undertaking should be en-

trusted to a company who would eventually buy themselves out by means of an annual rent accumulating as a sinking fund. That undertaking, having become obsolete, is also now being abandoned in favour of omnibuses. The company itself, and not the ratepayer, is suffering the loss of over £300,000 capital involved, apart from the absence of dividends or interest for many years past.

Of late years there has been a considerable development of the principle of establishing joint boards to exercise public utility functions over fairly wide areas. As regards water, apart from the Metropolitan Water Board, we have in the counties of Glamorgan and Monmouthshire five fairly large joint water boards. In connection with the Taf Fechan Water Supply Board, which includes as constituents twelve local authorities and another local authority as a purchaser in bulk, embracing a population of half a million, reference may be made to the exceptional provision to avoid unnecessary capital expenditure, namely, Section 28 of the Taf Fechan Water Supply Act of 1921: "No constituent authority shall at any time without the consent of the Board or if such consent be withheld without the consent after inquiry of the Minister of Health obtain or seek to obtain any new source for the supply of water or develop any existing source so as to obtain a larger supply of water than the supply properly available therefrom at the appointed day by means of the then existing works of the constituent authority."

The Manchester Corporation Water Undertaking is a notable example of a local authority maintaining a water undertaking which supplies outside areas of very considerable extent. The old theory that local authorities adjoining a pipe line could have a "drink" therefrom at preferential rates just where and when it pleased them, received a severe setback in the Manchester Act of 1919, which contained a clause requiring due notice before construction of intended reservations and payment to be made of a proper share of the actual cost according to the reservations; actual cost comprising not only the cost of maintenance and management, rates and taxes, but also interest on capital (including capitalised interest) at an agreed rate.

It may be observed (i) that the unfairness of a local authority refraining from making a reservation in the early stage of a water undertaking when the costs are heavy, but instead coming in at a later stage when the costs have become lower, is avoided; (ii) that a local authority pays from the time it makes its reservation notice, and not merely from the time it takes water; (iii) that while there is no contribution towards

sinking fund or repayment of debt, interest is payable in perpetuity.

In connection with charges for supplies by public utility undertakings, there is still room for uniformity. Water supply provides many anomalies. A lack of uniformity prevails throughout the whole system of charging domestic consumers: e.g. (i) Basis—this appears to be a choice between: (a) annual cost; (b) gross estimated rental; (c) rack rent; (d) rateable value, &c. (ii) The rate charged—(a) a fixed percentage throughout, e.g. Metropolitan Water Board, &c.; (b) a percentage rate, diminishing as the rateable value increases (with or without marginal relief between the “rests”); (c) an arbitrary scale; (d) in each of the above cases, with or without a minimum. The practice with regard to additional charges for baths, extra w.c.’s, &c., also varies greatly. The relationship between the scales of charges for trade and domestic consumers is often of an arbitrary character.

In the case of electricity, Mr. Cash shows on page 210, with regard to certain London electricity undertakings, that from 1925 onwards the companies are setting aside sinking funds for the redemption of capital, calculated so that in 1971 the whole of the undertaking will pass to the London and Home Counties Joint Electricity Authority, the same authority having to pay for stocks, stores, and debts taken over, and a further sum for assets acquired during the latter part of the term not fully provided for by the sinking fund. In this way the company would be repaid the whole of their capital then outstanding, and the undertaking passes into public ownership. The company are practically trustees for the ultimate owner, and a high technique of accounting is required. If, meanwhile, electricity in its present form does not become obsolete, and this scheme duly works out, we shall be afforded a classic example of the dog (to wit, the electricity consumer) eating itself!

Incidentally, I imagine that this principle might be extended to other public utility undertakings.

One may note in passing the provisions of the 1926 Electricity Act whereby profits must be used in relief of charges and not in reduction of rates except to the extent of $1\frac{1}{2}$ per cent. of the capital, that being regarded some years ago as the measure of difference between local authority and company credit. The margin is now much narrower.

In connection with the London Passenger Transport Act, the operation of which commenced a fortnight ago, Mr. Cash has shown that this large-scale amalgamation materially differs from other public boards. While

analogous to the Metropolitan Water Board and the Port of London Authority, the London Passenger Transport Act unifies under one control not only local authority but also statutory and private undertakings.

One great objection urged to public ownership by local authorities is that members elected by the popular vote are not necessarily gifted with the business knowledge requisite to manage commercial undertakings. In this connection, while far from deprecating the excellent work which members of local authorities undertake, I venture to quote from a book recently issued by Sir Ernest Simon, a former M.P. for a Manchester area, entitled "Practical working of City Government in England."

"Leadership, in any administrative job, is the essence of success.

It is surprising that the failure to provide it in English local government has not had more disastrous results. Consider what would be said if a similar organisation were applied to a great business concern. Suppose, for instance, at the next general meeting of, say, Unilever, some shareholder were to get up and say that he had studied the work of English municipalities, he thought it was very efficient and he would like to see a similar constitution adopted by Unilever. He therefore moved the following resolutions:—

- (1) That one hundred directors should be appointed by a general meeting of shareholders; their principal qualification should be their ability to address the shareholders in persuasive tones. They should be unpaid and should only devote a portion of their time to the work.
- (2) That the chairman should not hold office for more than one year at a time, and should devote the greater part of his time to ceremonial work.
- (3) That there should be no general manager, as the appointment of one man in general charge might be disliked by some of the heads of departments.

Such a shareholder would be set down as a lunatic, and he would be told that any concern run under a constitution of that sort would inevitably be bankrupt in a very short time. And yet his resolutions represent in fact the constitution under which the government of all our large cities is carried on."

It is interesting to observe, therefore, the special efforts that have been made in the case of the London Passenger Transport Act to combine with public ownership efficient business management. The members of the Board are to be selected by appointing trustees out of persons

qualified by past experience of finance and organisation and general business capacity to manage the undertaking. It is hoped by this means that the qualities of initiative and enterprise which are essential in any self-supporting undertaking shall not be lost under the new regime.

We are not concerned at this conference with the political aspect of control of charges and profits of statutory undertakings, but I aver that it is becoming increasingly apparent year by year that finance is the effective instrument by which real control may be exercised. By this I am not suggesting that the accountant is the handmaiden of Socialism, but that he is an indispensable factor in the process of evolution from individualism to rationalism cannot, I think, be seriously contested.

I am not concerned in this connection to put forward any claim for the antiquity of the accountancy profession. In this regard we must modestly give way to others. We understand that the world started from chaos, and nobody disputes that chaos is and always has been the undisputed province of the politician. But, looking to the future, in the carrying out of public control the accountant has taken and must continue increasingly to take an important part ; moreover, one may derive a certain amount of consolation from the fact that winding-up provides him with a job long after other participators have perforce disappeared from the scene. (Applause.)

MR. H. E. BOADEN, F.L.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, I also should like to join in the appreciation with regard to the most excellent paper by Mr. Cash.

Mr. Cash, in dealing with water undertakings in his paper, has stated that water companies have in many instances been transferred by purchase to local authorities. I should like to supplement his remarks in this connection.

In cases where such transfers have taken place, the results obtained under public and private ownership respectively are often compared, but when drawing these comparisons there is one point which is almost invariably overlooked by the average ratepayer. I refer to the fact that municipally-owned water undertakings are compelled by statute to provide for the repayment of the purchase price within a stated period.

Mr. Cash has referred to the fact that the Metropolitan Water Board Act of 1902 granted an exceptionally long loan period of one hundred years ; but in contrast to this a recent Act providing for the transfer of a water undertaking to a municipality stipulated that the purchase price must be repaid within forty-five years from the date of transfer. It cannot

be denied that this provision for capital redemption is a charge against the revenue of a publicly-owned undertaking from which companies are entirely free. Whether it is desirable that the purchase price should be repaid within such a comparatively short period is a debatable point.

The undertaking to which I have referred will be paid for by the present generation and the generation next following, and, in my opinion, it is not equitable that the cost of a permanent asset, such as a water undertaking, should be borne by two generations only.

Mr. Cash, in summing up his paper, states that two main facts emerge, one of which has reference to the protection of the interests of the investor in the various enterprises by giving him a reasonable return on the capital invested. It is, of course, necessary to protect the investor's interests to the fullest possible extent in order to attract capital on the most advantageous terms, but it is undoubtedly the case that the security offered to the investor upon transfer to a municipality from a privately-owned company is sometimes considerably increased, and, in my opinion, excessively. It might be interesting to compare the yield on the capital invested in the case I have already cited both before and after purchase by the municipality. The average annual yield on £100 invested in the water company's various stocks was £5 15s. 8½d., or 5.78 per cent. The stock issued by the municipality in exchange for this £100 produces £5 18s. 3½d., or 5.91 per cent. per annum, and in addition to the increased yield the stock and dividends thereon are secured on the *whole* of the revenues of the corporation, whether derived from the water undertaking or not.

Other instances of this inequality between public and private ownership may be found in tramways, gas, and electricity undertakings and the like. In fact, in these cases the inequalities have more serious effects than in the case of waterworks. As Mr. Cash has pointed out, the motor omnibus is a dangerous competitor of the electric tram, while gas, electricity and oil fight for the same markets. This acute competition often exists between public undertakings on the one hand and private enterprise on the other, and where such is the case the former is at a disadvantage because, as I have previously mentioned, of the provision for capital repayment. In normal times this charge on public undertakings would be unfair, and in the light of conditions prevalent in the world to-day it is doubly so. As a step towards lightening the burdens of municipalities, I consider that the provisions for capital repayment should be revised and that the periods of all such loans should be extended, thereby reliev-

ing the pressure of expenditure on public bodies and contributing in some measure to economic recovery. (Applause.)

MR. THOMAS HAWORTH, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, the subject of this paper is become increasingly important, and whatever one may think of the merits of the different forms of ownership and direction, it seems that some extension in the statutory control of charges and profits must be expected in the future. Moreover, it may not be easy to distinguish the relative and rightful spheres of operation as between private enterprise without any such control and public ownership involving control.

The author of this paper, as befits his distinguished record and his expert knowledge, has surveyed the ground very thoroughly, and it is quite impossible for me to offer more than a few general remarks, with perhaps some more particular reference to the position of public boards.

As the Chief Accountant of the Port of London Authority, which is often referred to as an example of the public board type, I am, of course, well acquainted with a measure of statutory control, not only in regard to charges, but in many other matters affecting our finances and operations.

The Board of the Port Authority, as you have been told, consists of 28 members and a chairman, of whom 18 are elected by the payers of dues and charges. Going back over the last nine years or so since I took up my duties, I can recollect very few cases indeed where the Minister of Transport, as the responsible Minister of the Crown in control of our charges, has been requested to intervene by traders on their behalf. If I may say so, while there is certainly no case in which he has had to hold anything in the nature of an inquiry or make a decision, I would put that comparative immunity down to the fact that the board is very largely elected by the traders themselves.

Whether a large board such as ours is better than a small board, like the newly constituted London Passenger Transport Board, may be open to argument, but unless there are difficulties in the way of obtaining a plebiscite of the interested parties I feel that an elected board in itself constitutes a safety factor both for the investors and for the user and consumer. I do suggest, therefore, that in the case of an elected board as distinct from an appointed board there is good reason for suggesting some relaxation from a fairly rigorous statutory control in regard to charges.

The control of profits in our own case is practically non-existent as a direct measure, since our revenue balance is to be applied for the benefit of the port as the board directs. There is, of course, an indirect control

of profits, or, at any rate, of dividends, by reason of the restriction upon the issue of port stock, though, since the state of the financial market also controls the rate of interest on our port stock and its issue price, it seems that the statutory control is, except in regard to total borrowing powers, almost superfluous.

When the Port Authority was established in 1909 it was given powers for raising additional revenue by levying a charge on goods imported and exported. These charges, which are known as port rates on goods, were, so far as London was concerned, of an experimental character, and no doubt it was felt that they should be rigidly controlled and curtailed. To that end the Port of London Act, 1908, contained elaborate provisions to protect the various interests. Firstly, a schedule of maximum rates ; secondly, provision that the rates on export goods should not be more than one-half the rate on imported goods, and, further, that the rates on coastwise goods should not be more than one-half the rates on foreign goods (there were a few exceptions, such as the case of coal and fuel, but they are of no consequence to the point at issue) ; thirdly, a provision that the total amount collected should not exceed 1/1,000th part of the value of the foreign import and export cargoes entering and leaving the Port of London ; fourthly, an instruction that the port rates collected on goods discharged within dock premises should be kept separately from the port rates collected on goods discharged outside dock premises, and a provision that if the amount collected on goods discharged outside dock premises exceeded 1/3,000th part of the sum total value of foreign import and export cargoes for each of two successive years, the Port of London had to take steps to rectify the excess.

I think it is now generally agreed that this formidable (I might almost say, tortuous) method of control was very much more than the situation required, particularly as the provisions have now been amended to cover nothing more than a schedule of maximum rates and charges.

It seems to me, considering the matter in all its aspects, the question and degree of statutory control must depend upon the measure of control already in the hands of the users and consumers, and that for this purpose, at any rate, an elected Board should ensure a greater measure of freedom from legislative restriction. (Applause.)

MR. W. H. BODDINGTON, F.C.W.A., A.I.M.T.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, may I refer very briefly to that section of the paper dealing with tramways ? These important statutory undertakings are rather summarily dismissed in

about twenty lines of print. One realises, of course, the difficulty of dealing, even at moderate length, with sections of such a paper as this. My few remarks will be supplementary rather than discursive.

For interesting historical facts relating to the operation of tramways in this country you are recommended to refer to a paper delivered at the 1932 Conference of the Institute of Cost and Works Accountants at York in October of that year, in which Mr. Gledhill, F.C.W.A., states that the first electric tramway (conduit system) in Great Britain was opened for the public service at Blackpool in 1885. In 1891, at Leeds, was introduced the first electric tramway with the overhead trolley.

The importance of tramways in this country is illustrated by the fact that the gross receipts earned by local authorities alone exceed 20 millions sterling per annum, and this sum is exclusive of receipts from the closely related trackless trolley vehicles and petrol omnibuses.

Any surplus or deficit on the tramways of a local authority in England or Wales may be transferred to the rate fund. Inevitably, this principle has a bearing on the question of charges and profits. In practice, reserve and renewal accounts are constituted out of which is met the cost of laying new feeder cables, reconstruction of cars, and new equipment, and so on.

A standard form of Abstract of Tramway Accounts for publication by local authorities was embraced in the Report of the Departmental Committee on Accounts of Local Authorities, issued in 1907.

I trust that these disjointed remarks supplementing the matter in Mr. Cash's excellent paper may be of some interest. (Applause.)

THE CHAIRMAN: I think that time has been against most of the speakers in completing the remarks which they have committed to paper. Will those gentlemen kindly hand their notes to the official reporter, and they will be included in the record of the proceedings.

I will now call upon Mr. Cash to reply to the discussion.

MR. WILLIAM CASH, replying to the discussion, said: Mr. Chairman, my Lord President, ladies and gentlemen, as far as I can see from the clock at this distance, I have about one minute in which to reply to about eleven speakers, so that I will be as brief as I can in order to make way for the next paper, and so that our proceedings may not be extended.

First, with regard to Mr. Collins and also with regard to several of the other speakers, I think they have been too kind to me, but I appreciate very much the remarks which they have been good enough to make about me and about my paper.

With regard to Mr. Collins' observations, he uses the word "monopoly" frequently. Of course, these undertakings are in the nature of a monopoly ; but, as he himself says in the course of his remarks, competition has a very important effect on the granting of monopolies of this character. In all undertakings except water it is right to say, so far as defined areas are allotted to them, that they have a monopoly. Then he said something about the feeling between consumers and proprietors, and there I agree with him, that I think present-day feeling between consumers and proprietors of undertakings is very much better than it was at one time, when it was the sort of acknowledged thing to pitch into or to attack the wicked undertaker who was carrying on these particular businesses.

Then it was interesting to learn from Holland the system employed there with regard to their railways, particularly so far as the system of Government guarantee was operative ; and we were interested also to hear about the life insurance companies. Of course you know that here life insurance companies work under special Acts, and there are special provisions for the protection of the insured.

Mr. Keen spoke on various matters. He drew a rather terrible picture of my appearing before a Select Committee of the House of Commons and having it all my own way. Of course, that is not so at all because I always find on the other side of the table either Mr. Keen or Mr. Collins. (Laughter.) Then, apparently, Mr. Keen is not satisfied and does not like this new method of "consumers' benefit," which has been deliberately chosen to meet certain factors which there is not time now to go into, but I would rather join issue with him on that. I do suggest there is protection for the consumer even where that system is put into use.

Then Mr. Muir referred to the difficulty of ascertaining the relative costs of production between power and electricity generated for lighting purposes. Of course, there is a statutory form of accounts for electricity, and the allocation of the particular costs as far as generation are concerned can be ascertained. I quite agree that it may be difficult to apportion them in regard to the particular purpose for which the electricity is used. I do not know that I can suggest any remedy for that difficulty.

Then Mr. Wilson spoke about the sliding scale, and acknowledged that the sliding scale is intended to share the benefit which may be derived from altered circumstances with the consumer ; but I think he rather did not lay quite enough emphasis on the fact that it is also intended to be a reward for efficient service, and in that respect, and particularly when the employees are brought in to share, I think the thing is very nearly ideal.

Then he spoke about the expense of proceedings. A great deal has been done in recent years to give the Board of Trade power—at all events, in respect of certain matters—to proceed by order rather than by Act of Parliament ; and that is intended to reduce costs.

Mr. Coates made some very interesting observations on the Electricity Act of 1926. Of course, it is early days yet to say what the effect of that will be. The provisions in the Act are very elaborate with regard to the system of selected stations, and also spreading the expense of standardisation and frequency over the industry as a whole. It remains to be seen how it is going to work. He acknowledges, as regards the ordinary maximum prices of electricity undertakings, that they are largely ineffective.

We were interested to hear from New Zealand about the peculiar position with regard to income-tax as between the electrical undertakings carried on by the Government and the gas undertakings carried on by private authorities.

Mr. Alban speaks with experience, and he quoted one very interesting case with regard to water, where very considerable discussions took place on the Manchester Bill. That was a case where water was drawn from a long distance. Then he referred to the lack of uniformity in the method of charges. That is quite true, but I think we are gradually tending to the domestic charge being based on the rateable value of the house rather than on the gross annual value or the rack rent. The first charge authorised in London was based on the number of chimneys in the house, which sounds rather a curious way of charging for water, but it was a rough way of ascertaining the relative size of the house.

Mr. Boaden referred to the charge for sinking fund which is a burden on municipal undertakings. Of course, in respect of some classes of businesses it is considered that that may take the place of what would be a charge for depreciation or renewals—perhaps more emphatically renewals in the case of a gas undertaking. He instanced the cost of a purchase where apparently the company made a very good bargain when it was transferred. I do not recognise the case personally, but I have no doubt his facts are right.

I was very glad to have the opportunity of seeing here Mr. Haworth, of the Port of London Authority. There is one little factor there which you will find referred to on pages 213 and 214 of my paper, that there is apparently a deliberate attempt in fixing their charges to favour export business.

Mr. Boddington referred to the important matter of trams. It is quite true that I dismissed trams with only a little portion of my paper, but

that was not done for any particular reason, but merely to try and keep the paper within reasonable bounds.

I thank all the speakers once more, and you, ladies and gentlemen, for the kind way in which you have been good enough to listen to me. (Applause.)

[The following notes were also handed in, but through lack of time the speech could not be delivered.]

MR. W. A. PEARMAN, F.S.A.A. (Great Britain): I should like to congratulate the author on the manner in which he has brought out all the salient points in respect of legislative action as applied to statutory undertakings.

I think most people will agree, especially those who are intimately concerned with working these undertakings in this country, that we have had a surfeit of Acts and Orders under which the undertakings have to be operated. Act follows Act in regular sequence, and, before one has assimilated one, another is on the Statute Book. If we could have a little respite from legislative interference to let us get on with our work, it would be of benefit to the whole country.

It would be very interesting to learn from our friends who are here from overseas whether in their respective countries they have any supervisory bodies such as we have in the Electricity Commissioners, or such a co-ordinating body for the generation of electricity as the Central Electricity Board. Also whether they could tell us how the local rates are assessed on the public utility undertakings in their countries, because I find that there are great anomalies in the manner in which these assessments are made in this country, notably as between undertakings that are owned by companies and by municipalities. The profits realised do not always form the basis of assessment.

Would the author of the paper agree that substantial economies would accrue to the public if undertakings of a kindred nature were amalgamated into large groups, so as to enable the most use to be made of the plant at their disposal for the common benefit?

Also the author draws attention in some detail to what has been done in this Metropolis for gas and electricity, &c. Is he of the opinion that similar provisions might be applied with advantage to the country as a whole?

THE CHAIRMAN: Before vacating the chair, I want on your behalf, ladies and gentlemen, to offer our thanks to Mr. Cash for the time and energy he has put into the paper, and for attending here to answer to the discussion. (Loud applause.)

WEDNESDAY, 19th JULY, 1933

Morning Session

CHAIRMAN: Mr. C. J. SHIELLS, C.A. (*President of the Society of Accountants in Edinburgh*).

HONORARY { Mons. C. JESPERSEN (Denmark).
CHAIRMEN { Herr Dr. W. VOSS (Germany).

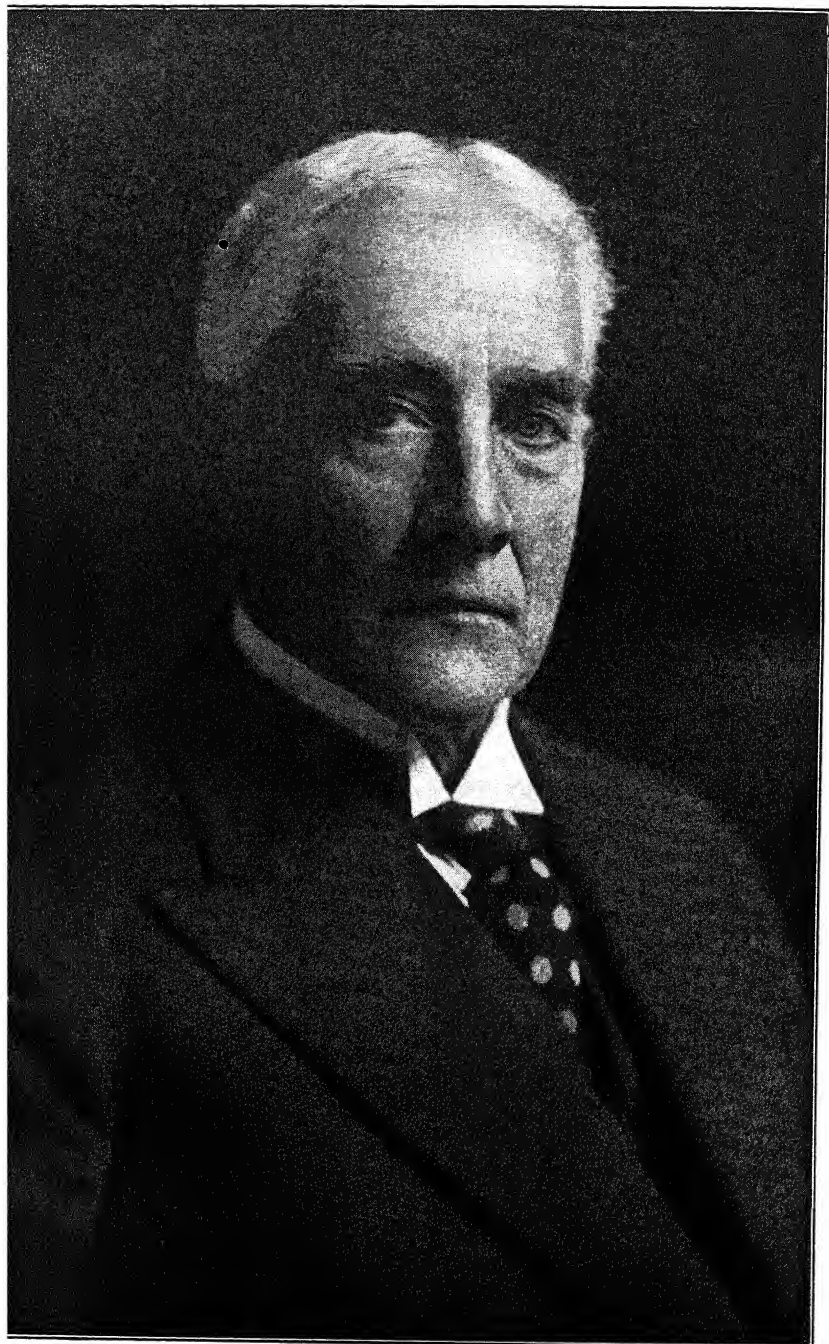
PAPERS

1. "Accounting as an Aid to Commerce"

PROFESSOR WM. ANNAN, C.A., F.C.W.A.

2. "Mechanical Accounting"

MR. ROBERT ASHWORTH, R.D., F.C.A., F.S.A.A.



MR. C. J. SHIELLS, C.A.
*President of
The Society of Accountants in Edinburgh*

1. ACCOUNTING AS AN AID TO COMMERCE

BY

PROFESSOR WM. ANNAN, C.A., F.C.W.A.

The subject on which I have the honour to address you is "Accounting as an Aid to Commerce." To an audience of accountants it may seem futile to discuss such a subject. It may be said that accountants do not require to be reminded of the many ways in which they serve commerce in the course of their practice, and that the manner in which they have been complimented in the past is sufficient proof that their services are effective. It is not putting it too high to say that we accountants have been hailed as a heaven-sent profession, without which commercial undertakings and other institutions, not excluding the State itself, would have been very badly off. Indeed we have been told this so often that we should be excused if we accepted it without reserve and made no attempt to ascertain for ourselves if, as a popular belief, it is justified or not. We need not quarrel with those who thus eulogise us, but, lest we should be falling into the unpardonable crime of self-complacency, it is well that we should take ourselves to task at times and consider whether, in spite of the many useful functions we do perform, there are any ways in which we may be falling short. We should in fact consider carefully if our service to Commerce might be improved and if so by what means that improvement can best be effected.

Speaking broadly, we serve commerce, and by commerce I mean industrial activity of all kinds, in three ways :

- (1) through those of our members who adopt a commercial career,
- (2) through professional services as auditors, and
- (3) as advisers.

1. Commerce as a Career

TRAINING

A youth who serves a term of articles or apprenticeship with a practising member of the profession and passes the prescribed examinations has an exceptional opportunity of qualifying for the higher commercial posts. The experience gained in assisting in the practical work of the profession and the knowledge acquired in preparing for the professional examinations make a combination which those responsible for selecting recruits for the accounting work of commerce have not been slow to recognise.

A professional accountant's office is evidently regarded as a singularly suitable place in which to receive a general training in business methods as well as in accountancy. There is some truth in the conception. The articled clerk or apprentice has a good opportunity of acquiring business habits. He lives in the right atmosphere. He learns about many kinds of businesses, and not the least of his lessons is the criticism he hears of the chief actors in the concerns whose accounts are being audited or investigated from time to time. He is thus led to appreciate the pitfalls that beset the man of business on every hand; he can note the methods by which these troubles are avoided or overcome by the successful, and the lack of method which proves disastrous to others. His lessons are extended and enhanced in value if his experience includes the winding-up of bankrupt estates or the liquidation of limited liability companies.

If he is fortunate enough to see and have explained to him the whole accounting and statistical organisation of one or two efficient modern businesses, he will observe what an important part the periodical statements submitted to the management play in controlling and guiding the destinies of the concern. If his duties have been limited to checking the accuracy of yearly balance sheets and profit and loss accounts, his knowledge of periodical statistics will be confined to what he has learned for his examinations. Comprehensive as these examinations are in this country, and they are frequently being adjusted to bring them into line with the needs of the day, they do not yet sufficiently stress the importance of "business statistics." It may be that the subject of "business statistics"

as a whole does not readily lend itself to written examination papers, and that an oral examination on certain parts is necessary, but no such difficulty arises in regard to cost accounting which in its wider interpretation is the most important phase of statistics.

In this connection it will be interesting to note the effect of the recent adjustments on the examinations of the English Institute and the Scots Societies of Accountants whereby more prominence is given to questions on cost accounting. It is a commendable movement which in time should have far-reaching effects. It must be remembered that tuition in a subject is largely guided by the questions set in that subject at the examinations, and if the questions are limited, so will the tuition be. Moreover, an articled clerk or apprentice will take a greater interest and search for examples in practice, in a subject which is given a prominent place in the examinations.

THEORY AND PRACTICE

Meantime those who are likely to go into commerce, should, while improving their theoretical knowledge of "business statistics," take what opportunity they can of observing how the theories they learn are being applied in practice. How far such opportunity will be open to them will depend upon how far their masters are consulted by clients regarding the statistical part of their businesses, and that again will largely depend upon the attitude adopted by the masters towards their professional work to which I shall refer later.

I emphasise this matter because it is now generally recognised that the executive of a large commercial or industrial concern must be provided with appropriate and reliable statistics. They are the chart and compass by which the course is marked and the ship steered, unlike the annual profit and loss account, which only tells the story of the year's adventures, and the balance sheet which shows the condition of the ship at the end of each voyage.

The trained accountant who goes into business should be able to provide what data is necessary. As the right hand of the manager he should be prepared to submit to him the kind of statistics that will meet the peculiar needs of the business :

Figures that will show the detailed expenses of the business.

Figures that will show the trend of the business.

The results of particular parts of the enterprise.

Proof that value is being obtained for what is being spent.

The effects of advertising campaigns.

The efficiency of travellers and agents.

Comparison with previous periods of the percentage rise or fall in such vital matters as gross profit, factory overheads, selling and delivery expenses, turnover, &c.

and particularly, in these days :

Frequent surveys of the factory order sheet, and

The effect on profits or losses of a restriction of output or an increase in production to meet lower selling prices.

An accountant who is actively engaged in commerce should, moreover, in conjunction with the management determine and record the reasonable standards of performance in every process or operation in the undertaking and provide for the consistent comparison of the actual with the standard performance. He should be ready to recommend and institute methodical investigation of any phase of the business which shows a decline in efficiency or failure to keep pace with any general trend towards improvement.

It is impossible to particularise all the kinds of statements that will be found serviceable ; anyone with accounting knowledge, average ability, plenty of commonsense and some imagination will, after acquiring an elementary knowledge of the trade concerned, readily discover what is best suited to the occasion. A flair for statistics is not necessary. Indeed a misguided devotion to statistics may be dangerous and may result in masses of unrelated and meaningless data which lead to nowhere.

The great advantage of the accounting control being in the hands of one skilled in statistics, as well as in bookkeeping and the preparation of accounts, is that he can arrange his system so as to provide the material for both the statistical statements and the financial accounts without overlapping, waste of time or unnecessary expense. The thorough grounding which he receives in the fundamentals of bookkeeping, and their application in the different forms that come under his observation, will have taught him how to evolve

a system to meet the needs of any particular case. Slavishly to follow an imperfect existing system, rather than think out and introduce a better, is a sign of mental laziness or incapacity, and action following upon independent thinking is a habit that every young accountant should seek to develop to the best of his ability.

It has been said that a group of figures may be seen with the eye but they are meaningless unless they pass through the brain. That is true, and should be kept in mind by the accountant who is called upon to devise and interpret statistical information for the executive of a business. By reporting concisely and intelligently on the favourable and the unfavourable conditions disclosed by the figures, he will save the manager's time and allow him to devote his energies to the practical affairs of the business.

MODERN RECORDING METHODS AND APPLIANCES

Knowledge of the application of statistics to commerce is incomplete without an acquaintance with modern recording methods. During the last quarter of a century a great change has come over office methods ; the pen has given place to the machine. The introduction of cards and loose-leaves in place of the bound volume gave the engineer his opportunity and he has replied with effect. In recent years he has put on the market machinery which borders on the miraculous. The magical powers of electricity have been harnessed to the typewriter and calculator, and the whole operations of recording sales or purchases, posting, adding and balancing, can be accomplished by simply tapping the keys of a specialised typewriting machine. More wonderful still, by the use of punched cards and electric machinery now specially adapted to meet the needs of commerce, statistics can be compiled in the space of minutes which, by the old methods, would take hours and perhaps days to complete.

The demand for more and yet more statistics, including complicated returns for State departments, has changed the whole style of the business office. Even the personnel has altered. The social effect, the removal of mental effort and the substitution of monotony through extreme division of labour are outside the scope of this paper. The effect on commerce, with which we are concerned, is that

office work can be executed more rapidly, up-to-date statistics and accounts can be produced in greater variety and, provided there is sufficient volume of work, at a great saving in cost.

For the accountant who adopts commerce as a career, an intimate knowledge of those developments is essential, otherwise he is severely handicapped. By observing them he will see new possibilities in the production of statistics and the speeding up of the costing records, which, as I have already mentioned, are of vital importance. The accountant who goes into business and keeps himself informed of the improvements that are occurring in the character of cost accounts in answer to the demands of the business world, will be enlarging his capacity to fill a post which is assuming increasing importance in modern business.

In the manufacture of its products each industry has its own recognised technique which has usually evolved slowly from experience, modified in recent times by the findings of the scientist. It would obviously be placing an impossible burden on the accountant to demand that he be familiar with the technical details of each industry with which he is concerned. Indeed his education and training may not have fitted him for the acquisition of such knowledge.

Nevertheless the accountant in practice, and to a greater extent the accountant who has associated himself with a particular industry, should acquire a knowledge of modern methods of manufacture. He should possess a degree of familiarity with the processes of manufacture sufficient to enable him to co-operate with the works and factory management in devising and developing statistical information. In a large undertaking the accountant becomes the liaison officer between the works or factory management and the directors who control the policy of the business.

2. Service as Auditors

HISTORICAL

It is interesting to note that in the petition for a Charter by the Society of Accountants in Edinburgh in 1854 there is no reference to auditing as being part of an accountant's duties ; it was so mentioned, however, in the similar petition by the English Institute in 1880.

Joint-stock companies were not unknown in 1854, but professional auditors, in the modern sense, did not then exist. The Companies Act of 1862 did not make an audit compulsory, although Table A appended to that Act, as specimen articles of association, contained audit regulations which any joint-stock company might elect to adopt. In 1879, after the failure of the City of Glasgow Bank, the audit of banking companies, and in 1900 the audit of all limited liability companies, was made compulsory.

We have thus had at least thirty years' experience of the auditing of joint-stock companies in this country, and the volume of work falling on professional auditors may be judged by the fact that in Great Britain alone there are over 114,000 companies on the official register, with a capital exceeding five and a half thousand million pounds sterling (£5,500,000,000). The number of individuals and private firms with accounts for audit is not available, but it must be exceedingly great.

VALUE OF AUDIT

After thirty years' experience it is not unreasonable to take stock and endeavour to assess the value of the audit as it is now being carried out. To the credit of the profession it may be said that the number of cases of alleged dereliction of duty on the part of the auditor, brought before the Courts, is exceedingly small and the number of convictions infinitesimal. That fact reflects favourably on the wisdom and foresight of the founders of the societies and their successors in office in setting and maintaining a high standard of examination and a strict code of professional conduct.

Nevertheless, we should not refrain from asking ourselves if, under modern conditions, we as auditors are giving as efficient service to the commercial community as we ought, if we are not being content to give only what is required of us by statute or case law, if we are not inclined to think more about the limitation of our liabilities than the furtherance of our clients' interests, and if we are not too timid in expressing our opinions and beliefs or in offering assistance in matters which do not appear to be strictly within the scope of an audit.

In considering whether our service is efficient or not, no one will

deny that the preparation of the young accountant for his work by concurrent study and practice is thorough and effective, or that there is ample opportunity in the accounting press and otherwise for the older members to keep themselves up-to-date in all that relates to the profession. It may be questioned, however, whether the practising accountant makes full use of the principles and precepts he has learned for examination purposes or in post-examination study.

COST ACCOUNTS AND INVENTORIES

For example, admitting the importance of cost accounts and their reconciliation with the financial accounts, does the auditor suggest their introduction where they are non-existent, and does he make use of them for the purpose of the audit where they are available? Does he check the quantities in the stock sheets with the stores books? Does he check the work-in-progress with the cost records? Does he consider whether the value of work-in-progress or finished goods contains a legitimate proportion of oncost, or inquire into the system of allocation of overhead expenses? Or does he conclude that costing is entirely outside the auditor's province and accept without inquiry the managing director's certificate of the value of stock and work-in-progress?

A case that came before the English Courts* recently prompts me to remark that in future an auditor who does not regard cost accounts as an integral and necessary part of a manufacturer's system of bookkeeping and make use of them for the purpose of the audit will receive little sympathy from the Court should trouble arise regarding the inventories of stock and work-in-progress from which the figures for these items in the balance sheet are obtained. I suggest that not only quantities, but prices also, should be checked by reference to the costing records, prices of completely manufactured goods as well as goods in process of manufacture.

For the purpose of valuation of stock-in-trade we have become accustomed to the phrase "Cost Price or Market Value," but what is the cost price of a manufacturer's own productions? What elements are to be included? It is clear that wages and material must,

**Westminster Road Construction & Engineering Co., Ltd.* (In Liquidation). *The Accountant*, 13th February, 1932

but if the cost of material has fallen since the goods were manufactured, is the lower figure to be taken ? If so, then the valuation is not based upon "cost price" but upon what might be termed "replacement cost."

Then what portion of overhead expense is to be included ? Obviously not the portion referable to selling and delivering goods, as that particular expense is not incurred, so far as the stock in hand is concerned, until such stock is sold and delivered. Nor should any part of the factory oncost representing interest on owner's capital invested in buildings, plant, &c., be included, as to do so would be to take credit for profit before it is actually earned.

Incidentally, I might remark that herein probably lies the solution of the controversy in accounting circles as to the propriety of including interest on owner's capital in the cost price of manufactured goods. I submit that in arriving at the cost price of goods in stock for balance sheet purposes, such interest should not be included, but in computing the cost price of a manufactured article for the purpose of determining the price at which such article may be sold, it is proper that interest on owner's capital should be taken into account. In other words, there is a cost price for valuation purposes, and a cost price for marketing purposes.

This leaves an apparent inconsistency in the treatment of interest on owner's capital and interest on borrowed money to be faced. Why should the one be included in valuation costs and not the other ? Why should the costs of a company with no borrowed money be less than those of a company which has borrowed money ?

If borrowed money could properly be termed capital, there would be no answer to these questions—the inconsistency would be real. But borrowed money differs from capital in that it is a debt payable, and interest on it is due irrespective of whether profits are earned or not. If capital is to retain its original and usual accounting meaning as the margin of assets over liabilities, debenture capital and loan capital are really contradictions in terms.

As valuation cost should include all expenditure incurred in production, there is no excuse in theory for excluding interest on borrowed money. If manufacturers exclude such interest in valuing

their stock-in-trade and work-in-progress, they are doing so not on account of any theory but either for the sound reason that otherwise the valuation would be too high considering all the circumstances of the time or that they had decided to create an inner reserve in this way. In determining costs for selling purposes of course, the point does not arise.

The cost of a product is not absolute. However carefully a cost has been ascertained, it requires interpretation in the light of the use that is to be made of the information. For example, a manufacturer who has reckoned interest in his costs may desire, for purposes of guidance in fixing selling prices, to exclude such interest. He may also require to know the amount of his direct costs, the expenses that fluctuate but not proportionally to production and the fixed expenses.

A further difficulty in the valuation of stock and work-in-progress arises when the production of a factory varies to any great extent from period to period. To illustrate the point in its simplest form, if oncost is applied as a percentage on the total productive wages, based on the relative proportion of oncost and wages of a prior period, is the percentage to be increased if the current wage bill is less or reduced if it is more than that on which the percentage is based?

There are other practical difficulties regarding the proper treatment of such extraordinary items as maintenance of idle machinery and plant, obsolescence, outlay during strikes, loss on exchange, &c. Are they to be included in cost or not? If they are included the accuracy of the costs will be hopelessly vitiated.

The matter of valuing stock-in-trade and work-in-progress has assumed a national aspect in this country, in respect that the Government have an interest through taxation in the trading results of every business concern. As taxation has increased, so the interest of the Government has become greater. At the present time, the British Government is a partner in every business concern, a partner who takes one-fourth of the profits but bears no share of the losses and contributes no part of the capital.

Obviously the taxing department of the Government, known

shortly as the Inland Revenue, will not be satisfied by a method of valuation that results in an under-statement of profits, even although as accountants well know, the under-valuation of stock, &c., at the end of a period merely has the effect of passing on the benefit which accrues on realisation to a succeeding period. From a taxing point of view, however, that is unsatisfactory, because it delays recovery of the tax and causes inequalities if the rate of tax changes.

Thus one of the questions put by the Inland Revenue concerns the basis of valuation of stock and work-in-progress. Hitherto the answer to that question, that the valuation has been made on the basis of "cost price or market value, whichever is lower," seems to have satisfied the Inland Revenue in regard to all classes of stock. There is no doubt about its suitability to raw material and bought-in stock, but the phrase does not seem to have a clear and definite meaning so far as a manufacturer's own productions are concerned.

Each individual manufacturer must answer the question in his own way. He will be wise if he values all his goods on the most conservative basis possible, and alters the terms of the certificate or gives such explanations to the Inland Revenue as may be found necessary. It cannot be too strongly urged that the annual accounts should be framed without considering what the attitude of the Inland Revenue may be regarding any of the items therein. Regard should be had only to strict and prudent business principles; the income-tax position can be elucidated by question and answer. As to the auditor's position, where the records provide information from which the inventory and valuation can be verified, is it not part of his duty to verify the details in that document in order to satisfy himself that there has not been an overstatement of quantity or an overvaluation in price, and in doing so to have regard to such questions as I have enumerated above? Where the records do not exist, he must, of course, adopt the best means available as a check on the stock and work-in-progress sheets, as certified by the chief executive.

PERIODICAL STATISTICS

The absence of the necessary records might advisedly be com-

mented upon by the auditor and a recommendation made for their introduction.

As to the question of how far an auditor can help his client in the preparation of periodical statistics, to which I have already referred, much will depend on circumstances. If there is a competent accountant, versed in this kind of work, on the client's staff, and that is common now in large concerns, the auditor may safely assume that he is not concerned with the statistical department unless by request. In the majority of businesses however, chiefly for reasons of economy, there is no such expert on the staff and the auditor is probably the only person with sufficient knowledge to prescribe the form of statistics that would be of value to those in control. Unfortunately, however, many of those in control of businesses do not appreciate the value of statistics, and the auditor has a natural reluctance to suggest their introduction lest he should be considered to be interfering and seeking to make work for himself at the expense of his client. Personally, I think he should risk a rebuff, and in general I am sure if he prepares the way judiciously, he will not suffer one.

In such circumstances, the first great adventure upon which we auditors should try to get our clients to embark is to institute the preparation of a series of *pro forma* balance sheets and profit and loss accounts at intervals throughout the year. The framing of these statements, after the first year, is not so formidable as may be imagined, and their value as guides to the conduct of business cannot be disputed. In these days of scientific office appliances and specially trained operators, there is little reason why anyone with a business of any size should have to await the production of his annual balance sheet and profit and loss account to tell him how he stands, and whether his operations have resulted in a profit or a loss. The backbone of such statements, the first step in the great adventure I have mentioned, is the monthly trial balance, in a pre-arranged classified form, and auditors, I submit, should urge the taking of that step wherever and whenever possible. Once it is taken, the way is open for developing a monthly statistical report of real value. Besides, it is in the interest of the auditor as well as the client to have the

books regularly and frequently brought to a balance.

CASH RECORDS

It may seem a minor point, but, as auditors' responsibilities are being made heavier, it is perhaps worth while emphasising the necessity also of enforcing the rule that all cash received should be paid into bank, and all payments except petty cash, which should be on the imprest system, be made by cheque. Adoption of this rule would be less uncommon if the forms of cash book prescribed by accountants and text-book writers were more suitably designed. As a graph loses its effect by overloading, so the popular form of columnar cash book has become a source of danger by overcrowding—a danger to both the auditor and his client in that cash defalcations are not easy to discover. What is the sense, for example, of cumbering the cash book with cheques drawn on the bank in favour of third parties? Theoretically it is wrong, and practically it leads to the danger I have mentioned.

If, while making sure that the accounts are true and correct as shown by the books, the auditor uses his critical faculty to suggest improved and, it may be, simpler methods of preparing these accounts and at the same time producing records for the guidance of the management, he will be increasing the effectiveness of accounting as an aid to commerce.

INCOME TAX

I mention only in passing the vast amount of work placed on accountants in looking after the interests of commerce in regard to income-tax, the necessity of mastering the intricacies of the taxing statutes, following the numerous tax cases which come before the Courts in ever-increasing numbers, and spending much time in corresponding with or interviewing inspectors of taxes in the adjustment of assessments.

In Great Britain and Northern Ireland the amount of income arising from industry and commerce assessed to income-tax is round about one thousand million pounds (£1,000,000,000), and it is safe to say that the bulk of this amount falls under review by accountants

year by year, and that accountants act for a large proportion of the two million persons who are subject to tax. This class of work has naturally fallen into the hands of accountants, as it deals with figures with which they are already familiar. It has become so much a part of their duty that auditors, in the course of their audits, spend a considerable amount of time in extracting the information which the inspector of taxes requires, thus saving their clients the worry of answering the many and troublesome questions that arise before the assessment is finally fixed. I think it is generally recognised that this class of work is a distinct aid to commerce, and that it will not diminish in importance in our generation or the next.

DEPRECIATION

Many articles on depreciation have been written for the benefit of accountants but it is an open question whether the principles enunciated on that most important subject ever reach the client and if so whether they are fully appreciated.

Whatever the legal view may be it is an axiom in accounting that no real profits can be said to have been earned unless provision has been made for depreciation of the fixed assets used in making and transporting the goods produced. Difference of opinion may exist among accountants as to the most appropriate *method* of providing for depreciation, whether it should be by equal or diminishing instalments, annuity or sinking fund provisions, insurance policy or revaluation at short intervals ; there is general agreement, however, that the *scale* of depreciation is not a matter to be determined by the accountant but that it should be fixed for him by those who have the practical qualifications to do so. The auditor is qualified to give an opinion about *method* but his knowledge regarding *scale* or amount of depreciation which mainly depends upon the expectation of life of the asset, is only such as he may acquire through observing the practice of other concerns.

In dealing with machinery and plant, for example, it is the practical man who determines the expectation of life of the various units or groups of units. To do this effectively, each unit or group must be considered separately, and obsolescence as well as wear and tear, must

be taken into account. In these days of rapid changes, obsolescence is probably the more important of the two. A machine may become obsolete long before it is worn out. Experience will tell which of the two factors should be selected as the length of life in each case ; the shorter the life the higher will be the rate of depreciation.

Having collected all relevant information, it is advisable that it should be set down in the form of a machinery and plant register which should be kept up-to-date by additions and cancellations. One of the columns in the register should show the expected life of the unit or group and the basis on which the value is to be written off during its lifetime. Another column will show the amount to be written off yearly and an abstract of the figures in this column for the whole battery of machines and plant will provide the figure which will appear in the profit and loss account as depreciation of machinery and plant. Such a register is a useful addition to the ledger account for machinery and plant ; it records in detail the lump figures in the ledger.

In many businesses no register of this kind is kept. Too often the only record of machinery and plant is the ledger account showing the purchases on one side and the amount written off yearly on the other. The purchases which may be for machinery of various classes, subject to varying degrees of depreciation, are brought together *en masse* and the depreciation is an overhead rate fixed more or less arbitrarily and not necessarily bearing a true relation to the actual wastage that is occurring. The frequent selection of a rate of five per cent. on the diminishing value of the aggregate amount seems to suggest a slavish adherence to a rule of thumb precedent or an unaccountable desire not to exceed the rate commonly allowed by the taxing authority.

In such a case what should the auditor do ? Should he pass the prescribed rate without question or should he suggest that its adequacy be tested by the preparation of a register, as I have mentioned, or by some other means of inquiry ? In asking these questions I am not concerned at present with the auditor's duty to the investor ; that ground has already been well covered by Lord Plender and others at the last Congress. Looking at the matter solely

from the " Aid to Commerce " point of view, it seems to me that we accountants who believe in the necessity for an adequate provision for depreciation, before ascertaining profits, should make a point of drawing the attention of our clients to the importance of the matter and show them in what way the sufficiency of the charge can be verified.

By so doing, we shall be helping them to avoid the danger of dividing profits that should have been retained to meet replacements and we may be the means of preventing violent fluctuations in the overheads for costing purposes.

3. *Service as Advisers*

SPECIALISATION

Medical men become experts in diagnostics through experience—the wider the experience, the quicker and more exact the diagnosis. Similarly, the accountant, by close examination and dissection of the accounts of business concerns which an audit entails, has opportunities of becoming expert in diagnosing business troubles. The degree of proficiency in this respect has hitherto been measured by the width of experience and the depth of the critical faculty possessed by the individual. Now specialisation is becoming a feature in advisory work.

Accountants who are accustomed to conduct intensive investigations of businesses must inevitably reflect upon the causes that normally lead to decline or failure.

A business may be overwhelmed by sudden and unavoidable disaster but I believe that to be exceptional. The causes of the decline or failure of established businesses is usually the insidious development of unsatisfactory features which may have been long unsuspected. In all too many instances the damages are serious, if not irreparable, before the causes have been detected. The reorganisation of a business usually demands time, money and not infrequently the introduction of a new element in the management. The accountant should be quick to detect the unsatisfactory features and should fully and frankly state his recommendations for their rectification.

RESEARCH

In this connection, may I suggest for the consideration of this assembly the propriety of initiating courses of Research in Accounting and the cognate subject of Economics for the benefit of Commerce and Industry. It is certain there cannot be real progress and development in a science without research of some kind, and as accounting has now reached the stage when it may fairly claim to be ranked among the sciences, it may not be amiss to consider whether the time is not now ripe for the introduction of a scheme or schemes of research with the object of raising the profession to a higher degree of usefulness.

The science of accounting is now wide and deep enough to command the undivided attention of men with trained minds, minds devoted to the study of particular branches of the subject in the same way as in chemistry and medicine. In this country, the little research in which accounting forms an integral part curiously enough has been undertaken not by accountants who have had practical experience but by bodies attached to the universities. I refer to the work of the Agricultural Economics Research Institute of the University of Oxford and the College of Agriculture in Edinburgh. During the last five years these bodies, with the co-operation of a number of farmers, have produced statistics of great practical value to agriculture. A scheme involving research in a limited degree has also recently been introduced by the London School of Economics.

In America work of this nature has been carried out for some considerable time. The University of Pennsylvania has a department of industrial research which amongst other activities, has been making investigations into particular industries. In the department of business history at Harvard the work of research takes the form of tracing the development of individual businesses, and there is also a department for collating returns from various kinds of enterprises and reporting results to traders who supply the information.

As an instance of the practical value of this kind of work, I might mention that the income-tax officials have accepted the average lifetime of machinery in the hosiery industry arrived at by the Pennsylvanian University research workers as the basis on which depre-

ciation allowance should be granted for taxing purposes, and the employers and employees of that industry have mutually agreed to submit their claims for adjustment of wages to the arbitrament of the University department to which reference has already been made.

You will agree that that is work of a very practical kind, and it is of interest to note that a young Scottish Chartered Accountant, who is also a graduate of the University of Edinburgh, is taking part in it. This graduate was successful in obtaining that rare prize, a Commonwealth Fellowship, and is the first accountant in this country, so far as known, to leave the profession for a period of research.

As an aid to commerce, research of this kind should be encouraged. It has great possibilities, but it cannot be undertaken without adequate funds. I do not know where such funds are to come from, but as a precedent I may mention that over two hundred years ago George Watson, the first professional accountant in Scotland, in founding a hospital for the education and maintenance of the children of "decayed" merchants, stipulated, according to a memoir written in 1725, that "having been successful in the improvement of his fortune by the help of bookkeeping he did particularly recommend that care should be taken that the children of the said hospital should be educated in these arts."

BUSINESS ECONOMICS AND FINANCE

Meantime accountants are performing work of a very practical nature in another sphere. The commercial world has gradually recognised the existence of a body of experts in professional accountants, and that is why they appear on the boards of directors of so many limited liability companies. In Great Britain I find no less than 700 names of accountants appearing on the directorate of over 2,500 joint-stock companies.

The complicated nature of the finance of modern commercial and industrial undertakings, arising out of reconstructions, amalgamations, absorptions and the creation of subsidiary companies, is no doubt largely responsible for the election of accountants to the directorate of large concerns. Often the appointment is at the instance of banks or other large creditors, whose interests the accountant is

commissioned to safeguard. In such cases he appears on the board in the role of a business doctor, and, provided he is not called in too late, he can apply his remedies with some hope of success. Like the medical man, he treats his "patient" as a "case," and so brings to bear an unimpassioned consideration and impartial judgment on the particular ailments disclosed. The employment of the accountant in work of this kind is eminently more satisfactory from all angles than engaging him in another capacity after the "patient" has expired.

The extreme difficulties of the present commercial situation are such that, the most urgent call to-day is for "the man who can take the broad view, who can form a just appreciation of the business situation and outlook as a whole, and who can co-ordinate and direct general policy from the standpoint of the far-seeing strategist."* Such a man must not be merely a learned theorist, but one who has had experience of the blending of theory with practice. That is the kind of experience an accountant obtains; he sees how the theories he has learned in his study of political economy, or economics, to give it its new name, work out in practice, and it shows the wisdom of our predecessors who included that subject in the syllabus of examinations for accountants.

So much importance is attached to economics by the Councils of the Scottish C.A. Societies that their regulations now require of every apprentice attendance at a class in one of the Universities or approved Schools of Economics, and a pass on a standard approved by the General Examining Board for Scotland. It was considered that such an arrangement would provide a more thorough grounding in the subject than the previous arrangement, which allowed each apprentice to select his own method of study and get through the political economy paper in the final examination as best he could. Thus equipped, the accountant of the future should be more capable than his predecessor of giving effective aid to commerce and industry in matters relating to business policy and development, especially when the ramifications are of an international character.

In routine work the advice of the advisory accountant is readily

* THE ACCOUNTANT & ECONOMICS, by Norman W. Duthie, C.A. *The Accountants' Magazine*, May 1927.

accepted, and it should proceed on the basis that it is more vital for the directors of a business to know immediately where it has made its profits and losses than to be told once a year how much it has made or lost. That is the keynote of the present day call for better bookkeeping for business ; that is why more books are being written on cost accounts than on any other branch of accountancy. The annual accounts may supply all that is necessary for those interested in the finance of the business. Financial policy may be determined on what they show, but finance alone will not turn losses in production into profits, and unless there are profits there will be no further need of finance. Finance occupied too prominent a place during the boom years, and many managers of businesses are to-day striving to pay dividends on capital that should never have been created, and the time of accountants is taken up with reconstructions of capital that should not have been necessary.

The finance of a business need not be difficult if the concern is prosperous. The first aim, therefore, of all businesses should be to make profits—that is the purpose for which they exist—and the accountant's main object should be to help in that process. In whatever capacity he serves, he should aim at assisting the management in the difficult task—extraordinarily difficult in these days—of planning, forecasting and testing by results, which can best be done for manufacturers by an up-to-date system of cost accounts, and for other kinds of businesses by statistical statements at short intervals.

CONCLUSION

While the present economic warfare lasts, when a business may be ruined by Government action, when margins of profits may disappear in a night through a change in the rate of exchange, and when the world is filled with goods for which there is no market, it may seem frivolous to talk to business men about improving their system of accounting. But from what I have observed, business men are appreciating the situation themselves, and, with the assistance of their accountants, are seeking to introduce new ideas in accounting and business method. Adversity is a good university, and blessed are they who pass through it in youth. It is a sad experience for

middle age, and a catastrophe for the old. That is true for a business as well as for an individual. But bad times may turn out to be good times in the end, and in every land may we all, and I hope soon, be able to repeat what Kipling said of the Boer War :

Let us admit it fairly,

As a business people should,

We have had no end of a lesson,

It will do us no end of good.

2. MECHANICAL ACCOUNTING

BY

ROBERT ASHWORTH, R.D., F.C.A., F.S.A.A.

The subject upon which I have been invited to prepare a paper for this International Conference of Accountants has been described as "Mechanical Accounting." There must be no misunderstanding, however, about this title, for there can be nothing mechanical about the function of accountancy. Mechanical accounting, therefore, can have reference only to the building up of the accounting and statistical data, by means of which the real function of accountancy is exercised, with the elimination, as far as possible, of the old laborious manual and mental method and the use of pen and ink by the substitution of mechanised method and the use of machinery.

The world-wide importance of mechanical accounting and the attitude of the accountancy profession thereto can be measured by the fact that this is the second paper on the subject given to an international conference of accountants.

The professional accountant is interested in this subject from several angles, arising from his dual capacity of accountant and auditor.

As an accountant, he is interested from the management point of view, because he not only has to meet the demands of management for information, but also has to influence those demands in the right direction. When advising as an accountant, he is also interested because his advice may be useless unless he can obtain the necessary data accurately, speedily and in sufficient detail.

As an auditor, he is interested in the subject from the angle of seeing that proper and adequate precautions are taken against fraud, that the use of machinery does not interfere with his duty of giving a conscientious report to shareholders or his clients without any mental reservations and generally that his statutory duties as auditor can be properly performed.

We shall examine, therefore, the question of mechanical accounting from all these points of view, but, in order that we shall do so with a proper perspective, it will be necessary for us first to see what has led to the growth of mechanisation in the office.

MECHANICAL AGE

This has been described as a mechanical age and certainly during the past thirty years there has been an enormous, and at one time unbelievable, scientific advancement. The tendency of invention during this period has been definitely to increase speed, decrease distance and greatly reduce physical effort. The scope of business operations has been exceedingly enlarged by the introduction of wireless, improved long distance telephone communication, improved methods of transport by land, sea and air, and the mechanisation of production.

Despite the intervening Great War the population of the world has increased enormously, thus increasing the wants of the people and the demands for employment. In Great Britain alone, during the past thirty years, the population has grown by nearly 9,000,000, while that in the United States of America has risen by nearly 47,000,000. World population is estimated to have increased by over 240,000,000 between 1907 and 1932, although there must be a large margin of error in this estimate, as many countries have no census, while others have only an inadequate census.

The result of these and other circumstances has been that competition, both national and international, has been intensified to such an extent that new and improved methods of manufacture have had to be found—firstly, to cope with the increasing demands, and, secondly, to reduce costs to meet the competition, so that the position to-day is that almost every country in the world is manufacturing under mechanised methods. Agricultural countries have turned their attention to factories and country people have flocked to the towns.

As an outcome of all this, mass-production principles have developed which have necessitated even greater use of machinery, almost to the exclusion of the old methods of manual production, and with

mass-production has come more scientific factory planning, greater attention to factory layout and a keener study of factory welfare.

This growth of mechanisation in production has been accomplished in spite of the greatest opposition from the worker, both individually and collectively. There is no doubt, however, that nothing can deter the progress of mechanisation and the time will arrive when we will have to give as much attention to unemployed labour as we do to unemployed capital, although the present chaotic condition of the world makes it difficult to determine the precise effect of mechanisation on the problem of unemployment.

We are not concerned here, however, with the economic aspect of mechanisation, except so far as is necessary to obtain a proper setting for the consideration of our subject of mechanical accounting.

ATTITUDE OF MANAGEMENT TO THE OFFICE

An enormous amount of capital has been employed in mechanising production and great attention has been given by management to its every detail. The office, however, has not received the same consideration, for it has been looked upon by many, up to within recent years, as a necessary evil, being considered merely a non-profit earning department of the business, having no other function, outside simple bookkeeping, but to provide figures when called for.

Office management has not been considered in the past as in any degree an important factor in the business, consequently progress in scientific office management has been slow and laboured. It has not kept pace with the progress made in the operative departments of the business and this lag has undoubtedly been a severe handicap on many concerns.

In a certain degree the desire for secrecy on the part of management has also played its part in preventing the adoption of modern methods in the office, for the fear of leakage of information to competitors has kept many accountants and their clerks tied to the old bound, and even locked, books of account, the use of pen and ink and the preparation of uninformative final accounts. Such clerks, however, were sometimes allowed to relieve the drudgery and mental

strain of calculation by the use of much beloved ready reckoners, slide rules and other similar aids.

It is remarkable how many concerns exist which are still content to accept a much lower standard of efficiency in the office than they are prepared to countenance in other departments of the business, although there has been a great improvement in this direction in recent years. Many concerns now employ fully qualified accountants to take charge of this branch of their affairs, which, at least, has ensured more efficient and scientific keeping of accounts and has assisted greatly in the education of management to the real possibilities of the accounting function.

The importance of the accountancy profession itself was, of course, fully recognised by the State in this country during the Great War, when it was scheduled as being work of national importance.

The necessity for planning business operations and the increased demands of management, created by the rapid growth in the volume of business transactions, have brought an alteration in the attitude towards the office and accounting functions to such an extent that the large majority of successful businesses to-day are those which have made the office the heart of the concern, from which life is pulsated into all the arteries of the business, whether they be in production, purchasing, selling or administration. There are, of course, cases where businesses are successful from a profit point of view in spite of bad management, but when such businesses are investigated they are generally found to be full of wastages and leakages, to which the management is blinded by the profits earned and lack of knowledge of the real accounting function.

The dimensions of business operations, the keenness of competition and the obstacles placed against the development of foreign markets at the present time have required management to give increasing attention to the following questions :—

- (1) The tracking of wastages and leakages in all the ramifications of the concern, including that of management itself.
- (2) The prompt elimination of unprofitable lines or departments.
- (3) The prevention of the lock-up of working capital unnecessarily and its remunerative employment.

- (4) Costs of production, selling and administration.
- (5) Price fixing and markets.
- (6) Saving of executives' time in purely administrative work, such as signing cheques.

In consequence, management has been driven to the office for aid in attacking these problems, with the result that improved statistical and accounting systems and methods, requiring more detailed and automatic analysis than formerly, have had to be evolved for dealing with storekeeping, stockkeeping, costing, wages, purchasing, sales, hire-purchase, factory accounting, cash accounting, main accounting and budgetary control, so that information will be quickly and readily available with the greatest possible accuracy.

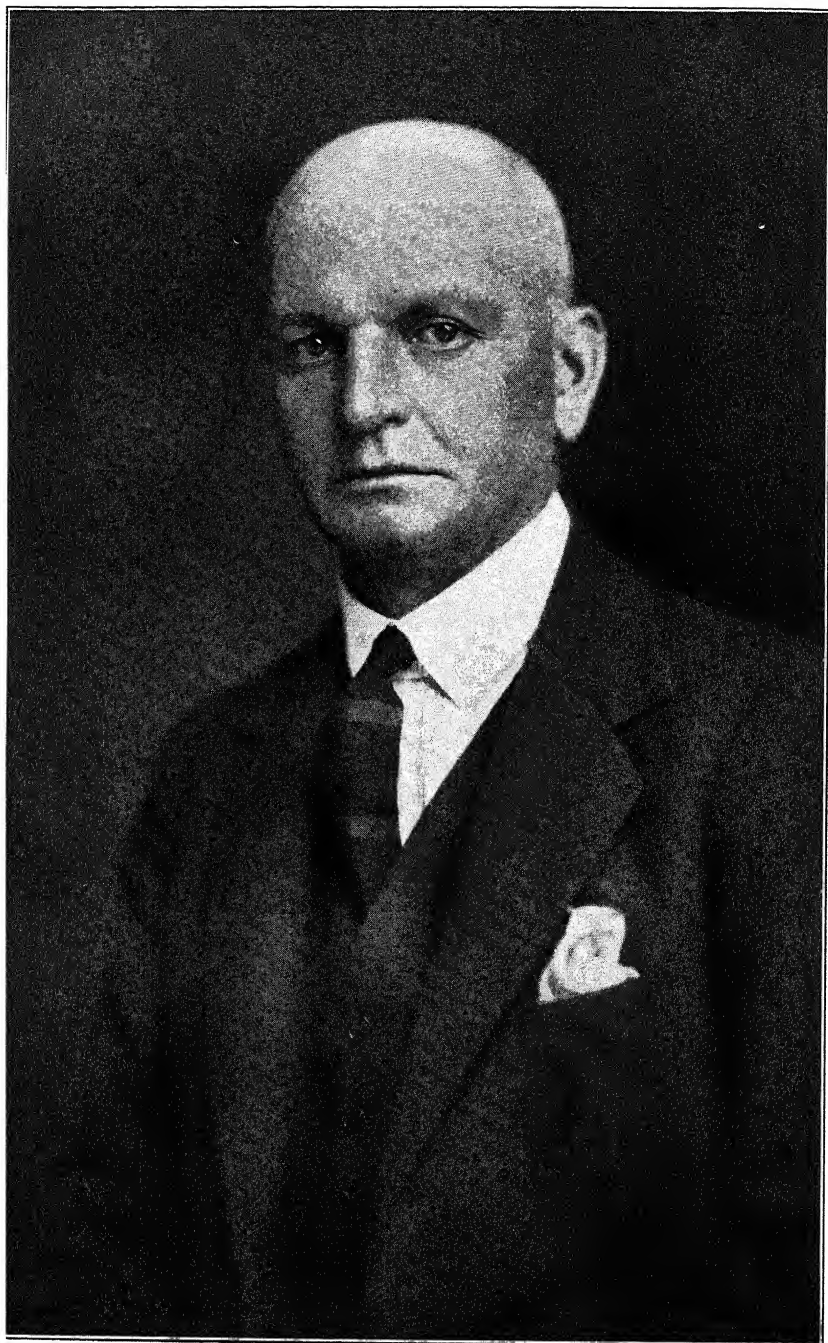
The initial slow response to the calls of management soon revealed that, at least in large organisations, equal attention must be given to the administration, mechanisation, layout and welfare of the office as to any other branch of the business.

To-day, management has to be guided by the office to a very great extent as to the amount, quality and use of the information which shall be placed at its disposal and it is here that great restraint must be exercised to prevent that information becoming so voluminous as to be both wasteful and useless.

For all practical purposes, however, it is futile to give management information as to wastages and leakages, unprofitable lines, excessive locking-up of working capital, inaccuracies in estimated costs, &c., months, or even weeks, after these events have arisen and the facts have become business history.

Management must have its information accurate, up-to-date, legible and in the most easily digested form, so that the time of executives will not be taken up searching for the facts, but in seeking and applying the remedies with the utmost despatch, which is one of the principal functions of management.

It seems obvious, therefore, that if these demands are to be met efficiently, and industry and commerce are to receive the complete assistance of the accountancy function, the old pen-and-ink methods used in the office must be greatly reduced and in the main replaced by the use of up-to-date methods of accounting and the employment



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[Photo by Morgan]

of machinery, in order that the more detailed analysis now required in present-day business may be forthcoming with the greatest accuracy and speed and at the least expense.

In dealing with this subject of mechanical accounting, it must be made quite clear, however, that we are considering only one branch of office management. It is, of course, the main branch, as it has inseparably tied up with it the consideration of accountancy and statistical methods.

We shall see later in this paper, however, that office machinery must be the handmaiden of the accountancy system and not its master. We shall have to consider, therefore, the function of the accountant, accounting and statistical system, and the position of the auditor before we can deal with the office machinery itself in its proper place as the servant of the accounting function.

FUNCTION OF THE ACCOUNTANT AND GROWTH OF ANALYSIS IN ACCOUNTING

The accountant, whether he be employed internally or professionally in that capacity, is one of the very few people who are in a position to see the business as a whole and to this extent his responsibility is all the greater, because he is in the privileged position in which a detached view of the concern is acquired, thus enabling him to use his powers of analysis to complete the picture of the entire activities of the business free from departmental bias.

Much has been said and written about the duty of the auditor, but the duty of the accountant has received very little attention, except on the rare occasions it has been necessary to discuss it in the Law Courts, purely from a legal angle, in the attempt to assess damages for negligence, or fix a sentence for some criminal act of "cooking" which he may have been induced to use in place of accounting.

At one time he was considered to be a good and dutiful accountant if he could prepare a neat-looking trading and profit and loss account and balance sheet, which took adequate care of the distinction between trading (which included manufacturing) and profit and loss expenses, and carefully assessed the difference between capital and

revenue expenditure, thus arriving at a fairly accurate gross and net profit for the given period and the statement of the position of the business as at a certain date.

The process of analysis of accounts then developed and the accountant was required to make a further subdivision of his trading account by the inclusion of manufacturing accounts and,* as the scope of the business enlarged, to provide for branch and foreign accounts and to prepare, now in departmentalised form, his manufacturing, trading and profit and loss accounts at more frequent intervals.

The principal function of the accountant then was to prepare these accounts, arithmetically correct and balanced, accounting for the transactions that had taken place during a given period. His other duties were to render debtors' accounts and receive payments and keep creditors' accounts and make payments, also to provide such statistical data he may be called upon to supply, which rarely amounted to more than the production of a periodical bank reconciliation statement and statements of sales and expenses sometimes in comparative form. In other words, the duties of the accountant some twenty-five or thirty years ago were those entrusted to the bookkeeper and cashier to-day.

With the growth of business and the introduction of heavy taxation, including excess profits duty, the accountant had to make a still greater analysis of his accounts for the purpose of business and taxation investigations.

At the outset, this analysis was done by way of back analysis of the bound books of original entry, that is to say, at some period after the transactions had taken place he would go through the books of original entry and analyse each item under its respective head, which was an extremely laborious method and by the time the analysis was ready its value, at all events for vital business purposes, was considerably discounted by the lapse of time. From this grew the analytical books of original entry, such as the purchases and sales journals, returns inwards and outwards books, the analytical cash book, &c., and here was the commencement of automatic analysis, under which the transactions of the business are analysed

as they occur, still, however, at this time accomplished in bound books with pen and ink.

This automatic analysis was an improvement on the old back analysis method, both from the points of view of efficiency and economy, but business continued to grow and the accountant found that to cope with the increased analytical work required he had to introduce loose-leaf and card ledgers, loose-leaf books of original entry and the slip system, thus bringing into greater use as an accounting medium the documents of original entry. The introduction of costing methods also acted as an incentive in this direction.

At this point the accountant called to his aid the typewriter, the adding machine and the use of fanfold, interfold and continuous stationery. He also began to take a keener interest in the classification of accounts, the marshalling of assets and liabilities in the balance sheet and the presentation of statistical data.

So the work of analysis has continued to increase and the physical and mental effort involved in the work continued to decrease, until to-day in well organised accounting systems automatic analysis is complete, being made possible only by the use of machines, amongst which are those combining the functions of the typewriter and adding machine, which had previously been used separately.

So much for the growth of analytical accountancy, but what is the duty of the accountant to-day? Mechanical accounting has relieved him of practically the whole of the drudgery and tedium of calculation and analytical work and has given him time to discharge the added and more productive responsibilities of administration which the increased ramifications of business have thrust upon him.

To-day, the accountant must not be merely a collector and arranger of figures, he must be an interpreter of them and, in order that he may properly interpret, his accounts and statistical data must tell him the whole story of the business operations. Without adequate and automatic analysis this cannot be done and, in the absence of the aid of office machinery, there can be no adequate and automatic analysis, except at enormous expense, if the business is of any magnitude.

Management is not so much concerned with a statement of increases or decreases in turnover, expenses, costs, profits or losses, working capital and net assets, as it is in the reason for such a state of affairs. Management wants to know why there is an increase or a decrease and it desires information as to where and how the wastages and leakages arise. If, therefore, the accountant wishes to be looked upon as a productive power in the business, he will supply that information by utilising the time released to him and the improved facilities afforded him by mechanisation for the purpose of intelligent investigation.

If, however, the accountant is to take full advantage of the benefits of mechanical accounting, he must beware of the dangers involved in the use of office machinery. He, therefore, must have regard to the following :—

(1) *The proper relationship of mechanisation to the accountancy system.*

The accountancy system must be paramount and the fundamental rules of accounting procedure must be carefully preserved.

The machine should be applied to the system and not the reverse. This does not mean that there will not have to be some adjustments of accountancy method when machinery is installed ; on the contrary, there will probably have to be a great deal of adjustment, but it does mean that the usual accountancy safeguards must be taken care of either by the machine itself or by the accounting system.

The accountant must not allow excellent salesmanship to induce him to put into operation a machine which will give results only by the employment of the accounting system sometimes offered with the machine, unless he has carefully examined the possibilities of that system, as well as the efficiency of the machine itself, and has satisfied himself that it meets all his requirements from an accountancy point of view.

On the other hand, while investigating, he must keep an open mind and not allow prejudice to blind him to the greater efficiency and economies resultant from mechanisation in the office.

(2) *Over-burdening the machines with unnecessary work.*

The accountant must not allow the ease with which analytical work can be accomplished by machinery to lead him into the great

mistake of over-elaboration and the placing of work on the machines which is not essential to meet business requirements. Otherwise he will find that he will soon be installing more machinery than is necessary, with the result that his accounting and statistical expense will rise enormously.

In addition, the information he supplies for executive use will tend to become so voluminous that, however valuable it may be in itself, it will be ignored and in consequence will become wasted by lack of use and therefore valueless for business purposes.

This danger of placing unremunerative work on the machines is one of the greatest pitfalls of mechanical accounting and one against which the accountant must take special precaution.

(3) *The elimination of work which has ceased to be of service.*

All forms and information produced by the machines must be under the continual examination of the accountant, to ensure that altered requirements of the business are catered for.

In this respect there is a tendency for executives to ask for information for a specific purpose and, when that purpose has been fulfilled, for the supply of the information to be continued indefinitely unless proper supervision and control has been exercised by the accountant.

The accountant is the mainspring of mechanisation in the office, although the accountants of many of the large concerns delegate their duties in this matter to a mechanisation officer. Nevertheless, if the mechanisation of the office is to be successfully achieved, the accountant must have :—

- (1) A high conception of his own duty as accountant, in order that the most efficient use of mechanical means may be effected.
- (2) A complete knowledge of the accountancy system, which he should reduce to paper in the form of a system's chart, showing the link between the various sections of his department.
- (3) A thorough knowledge of the organisation of the business, for which purpose he should compile an organisation chart for constant reference.

(4) The ability to win the co-operation of his own staff.

Staff co-operation is one of the most important and, at the same time, most difficult questions in the mechanisation of accounting.

We are all aware of the strong opposition put up by the manual worker against the mechanisation of production, involving as it did in the early stages riot, civil commotion and the breaking up of machinery.

There is, however, nothing to be afraid of in this direction from the office staff, because, firstly, they have become used to the idea of mechanisation in production and, secondly, the standard of education is now on a considerably higher plane than was the case when machinery was first introduced into the factory.

The fear of loss of employment, however, naturally raises intense opposition against mechanisation in the office. This opposition usually takes the form of an endeavour to upset the smooth running of the machinery, or the smooth working of the system.

It, therefore, is of importance that the accountant does his utmost to remove the suspicions of his staff during the process of mechanisation. The main lines of attack in this direction are as follows :—

- (a) That the process of mechanisation will take time before it can work effectively.
- (b) That the machinery is required to cope with additional work.
- (c) That staff will be released for more important and constructive work.
- (d) That displaced staff will be taken care of, either by pension or by giving sufficient notice of termination of service to allow them to obtain other employment and by providing every facility for them to do so.
- (5) The co-operation of the auditor.

It cannot be too strongly stressed that no mechanisation of the accounting system or alteration in method of accounting should be permitted until the auditor has had an opportunity of examining the proposals, otherwise he might be placed in serious difficulty not foreseen by the accountant. We shall consider the position of the auditor, however, in more detail later in this paper.

- (6) The personality to enable him to win, or, alternatively, to

command, full support from his colleagues on the executive, in respect of any changes in method which affect their departments.

(7) An open mind and freedom from prejudice.

It is also of importance to the success of mechanisation in the office that all forms in use in the business should be under the control of the accountant, in order to ensure standardisation and avoid duplication of effort, which is a constant source of waste in business.

We shall consider other matters of importance affecting the accountant when we deal with the question of installing the machinery.

SCOPE OF ANALYTICAL WORK AND ACCOUNTANCY SAFEGUARDS

It has already been stated that the machinery must be the servant of the accounting and statistical system. Before, therefore, we can properly consider the machinery itself, we must have a knowledge of the work it will be required to perform and the safeguards that must be protected.

The amount of analytical work to be done will, of course, differ considerably in various concerns, according to the ramifications and nature of the business and the degree of efficiency it is desired to attain in the accounting and statistical system. It does not follow, therefore, that because a certain method of mechanisation has proved to be successful in one particular business it necessarily will prove equally efficient in another.

It has been indicated previously in this paper that the whole question of mechanisation of accounting is tied up inseparably with sound accounting and statistical policy. It is essential, therefore, to consider this question, even to the examination of certain detail which may be considered by many accountants as being merely in the ordinary course of accounting procedure, for no method of mechanisation can ever be fruitful unless the accounting and statistical systems are on a proper basis.

This part of our subject can best be considered under the following heads :—

(1) Classification of accounts.

- (2) Budgetary control.
- (3) The accounting and statistical system.

CLASSIFICATION OF ACCOUNTS

The most important function of modern accounting is to present and interpret in an accurate and intelligent manner the results of the millions of transactions which take place in every active concern. If, therefore, that function is to be properly exercised so that the accounts will tell the whole story of the activities of the business, it is essential that there shall be a proper and adequate classification of accounts, so that all transactions of the same kind are treated in the accounting procedure in identical manner. A standard and consistent method of analysis is an indispensable condition, both to the success of the accounting function and the efficiency of mechanical methods.

To ensure consistent analysis, it is necessary that instructions be prepared laying down a standard practice for dealing with all accounting items and once a standard practice has been established it should be interfered with only on the rare occasions necessary to meet changing conditions in the business. Otherwise, the inevitable consequence will be misleading and unintelligible results. It is obvious that, unless a standard practice of classification of accounts is adopted, all the work and expense of mechanisation will be rendered abortive.

When a properly planned classification of accounts has been developed and adequate instructions have been given as to its proper use, a better understanding of the accounting function will be realised throughout the organisation, which will greatly increase the prestige of the accountant and facilitate the introduction and use of machinery in the office.

The extent and nature of the classification will depend, of course, upon the size and constitution of the particular business and the extent to which the demand for adequate information has been fostered in the organisation. Care, however, must be exercised to avoid over-elaboration and, therefore, the expense of obtaining any desired analysis should be weighed carefully with the advantages to be gained from the additional information.

Expense accounts, in addition to being classified as to the nature of the expense, should also be classified as to department, so that an effective system of budgetary control, which is almost indispensable in any large business to-day, can be put into operation with greater ease.

It is advisable in attacking this question of proper classification of accounts to commence with the final accounts of the concern, for all analysis should provide the background and supporting data for these accounts. There must be properly constructed manufacturing and sub-manufacturing accounts, trading accounts and profit and loss accounts. These accounts should be so arranged as to be readily adaptable to the costing system, while at the same time they should show clearly the result of the operations in all the fields of activity exploited by the business. This calls for proper arrangement and grouping of all the items in those accounts, in the course of which the proper classification of all supporting accounts must necessarily receive attention.

It must also be remembered that the balance sheet, although not an account itself, is a statement of assets, liabilities and capital, purporting to show the position of the business as a going concern and is a summary of the balances of various accounts, as at a given date. Let it show that position by proper arrangement of those assets, liabilities and capital, so that information as to working capital, net assets and reserves can be readily ascertained.

We are considering, of course, this question of final accounting from the point of view of classification of accounts and their adaptability to business requirements and not from the point of view of disclosure to shareholders, which subject is not within the scope of this paper.

The object in first obtaining the proper arrangement and classification of items in the final accounts and balance sheet is so that they will form the basis for planning the scope of the analytical work necessary for the proper classification of accounts generally and determining what analysis shall be left to the pure accounting function and what shall be provided through statistical channels.

BUDGETARY CONTROL

Efficient organisation demands to-day the careful planning of all operations and effective control of expenditure throughout all the ramifications of business and, to meet this demand, further analysis has been called for to build up the system of budgetary control. In fact, budgetary control is nothing more than the control of the finances and operations of an undertaking by the setting of standards and the subsequent detailed comparison of actual results with those standards. If, however, these comparisons are to be effective they must be made in sufficient detail to enable wastages and leakages to be tracked readily.

Without a proper system of analytical accounting and the use of adequate office machinery, it is safe to state that the full demands of budgetary control in large concerns could not be met and, at best, the result of any such attempt would be merely the production of a guesswork budget lined up with more or less indifferent final accounts.

The budget, itself, is based to a large extent upon past experience, the record of which cannot be relied upon unless there has been in existence an efficient organisation of the accounting function.

We are, of course, only concerned in this paper with budgetary control in so far as it affects the analytical work of accountancy. We shall get a better grasp of the scope of analysis in this work if we examine the usual procedure adopted in compiling and using the budget, which is as follows :—

- (1) The marketing research and sales departments will make their estimate of turnover and advertising, selling and sales administrative expenses. The turnover will be analysed into quantities of detailed commodities.
- (2) The factory will then draw up its production schedule, based upon the sales department's estimate of turnover. Labour and material and other variable expenses required to meet the programme will then be estimated.
- (3) The purchasing controller will line up his programme and prepare his departmental expense budget, which may be combined with the factory estimates, or may be dealt with separately according to the particular form of organisation adopted.

- (4) The sales and factory estimates will then be carefully examined by the managing director, or controller, and after any necessary adjustments have been made will be handed to the chief accountant.
- (5) The chief accountant then prepares his budget of administrative expenditure and finally the cash budget and the complete manufacturing, trading, and profit and loss budget, which, after being passed by the managing director, or controller, is placed before the board of directors for adoption.
- (6) The manufacturing, trading, and profit and loss budget will then be handed to the cost department for the preparation of standard costs.
- (7) Subsequently, there will be an automatic analysis of the actual turnover and expenditure under the proper classifications, which will be compared with the budget figures and investigation directed where necessary.

Both in the compilation of the budget and the comparison of the actual figures with that budget, machinery plays an almost indispensable role in analysing and building up the required data.

It will have been realised, however, from the scope of the budget that much of the analysis required will have been accomplished in the ordinary accounting procedure, if there is in existence a mechanical accounting and statistical system which is fulfilling its proper function.

THE ACCOUNTING AND STATISTICAL SYSTEM

The adjustment of the accounting and statistical system to mechanical methods is one of the most important factors to be considered in the introduction of mechanical accounting. We cannot, of course, go fully into this question by dealing with the many different mechanical accounting and statistical systems which are involved in the many different classes of business, otherwise we should have to consider a book of no mean size instead of a paper on the subject of mechanical accounting.

It is necessary for us to bear in mind, however, the volume of

analytical work required to meet present-day needs of business and to consider the accounting safeguards which must not be overlooked when any adjustments in method to meet the requirements of machinery are contemplated.

Each branch of the business has its own claims upon office mechanisation and these will, of course, vary according to the size and nature of the business.

For the purpose of this paper we will divide and examine the volume of accounting and statistical data required under the following heads :—

- (1) Factory accounting and statistics.
- (2) Purchasing accounting and statistics.
- (3) Sales accounting and statistics.
- (4) General accounting.

We, however, shall be able to deal only with the general principles involved.

Factory Accounting and Statistics.

The factory manager has a greater regard for factory statistics and system to-day than formerly and finds that it is now a practical impossibility for him to run his factory efficiently without adequate accounting and statistical information.

In addition to proper and adequate manufacturing and sub-manufacturing accounts showing in total materials used, direct and indirect labour and grouping the fixed and variable factory overhead charges under separate headings, he requires this information to be analysed for him over departments, processes and costs. He also requires statistical information with regard to orders received and executed, daily output in each department, progress and production planning, up-to-date costing, labour and machine efficiency, control of stores and stock of manufactured parts, factory internal and external transport, fuel consumption and efficiency, &c. He is not content with values, he also requires quantity information under proper classifications.

The factory manager is also definitely interested in the capital employed in his factory and sometimes desires to know how that

capital is pulling its weight with regard to the departmental factory space occupied, either per square or cubic foot.

Apart from factory accounting, his principal contact with the office is in connection with costs and, in addition to overhead charges, this covers the two most important factory items from the points of view of office mechanisation and the preservation of accounting safeguards, namely materials and labour.

Materials. The cost department, of course, is not concerned with materials until they are issued, but there must be adequate safeguards as to proper receipt of the materials, efficient store control and the proper issue of materials.

Formerly, the practice was to enter up details of the goods received in a goods received book and time was often lost later when the invoice was received in searching for information of the receipt of the goods. To-day, these particulars should be recorded by typewriter on a form called an "apron," giving details of the receipt of the goods, one copy remaining in the goods inwards department as a store record and the other being sent to the central invoice department to be attached to the invoice when received. This "apron" system not only saves time in dealing with the goods, but ensures that particulars of all outstanding invoices are readily available at balancing periods and that store and stock records are kept up-to-date.

The stores should be controlled as to maximum and minimum quantities to be kept and the store records, to facilitate easy reference, should be typed on visible index cards. This method should prevent the unnecessary locking-up of working capital in the purchase of materials, which is a matter of the utmost importance in these days of violently fluctuating prices and one which no management can overlook without placing the whole business in jeopardy.

Stores should be issued only on production of standardised requisition forms, which should contain all costing information and should be signed by a responsible party, such as the shop foreman. The information as to issue of stores will be scheduled each day under the respective cost operation numbers and a copy sent to the costing department. A proper system of dealing with surplus mate-

rials issued will also have to be provided by the use of supply notes from the factory to the store. The method of handling the stores requisition for costing purposes will, of course, vary according to the type of office machinery used in the costing system.

Where tabulating machinery is in use cards will be punched with the requisite costing information.

Continuous stocktaking systems in large businesses would be rendered inefficient without the use of office machinery, more particularly is this so where there is in existence a unit stock control system. Formerly, the half-yearly physical stocktaking was relied upon almost entirely for stock information. To-day it would be extremely difficult, if not impossible, to keep pace with business under such conditions and physical stocktaking is now looked upon as one of the safeguards, acting as a check upon the continuous stock-taking system. This safeguard, of course, must be preserved, being now rendered much less expensive and much more simple by the use of modern store methods and the employment of adding and calculating machines.

The office machinery employed in analysing materials will depend, of course, upon the size of the business and the nature of the analysis required. There may be a combination of calculating machines and typewriters with detachable adding box attachments called totalisers, accounting and statistical machines may be used, or the whole of the work may be done by tabulating machines together with their accessories.

Labour.—The amount of analytical work required and the speed with which it has to be prepared in connection with the labour expense of the modern business is so great as to render pen-and-ink methods almost obsolete.

This work naturally divides itself into two parts, which form a total check upon each other, being those of accounting analysis and statistical analysis.

The accounting analysis provides for the preparation of the pay roll, dissecting the total salaries and wages over departments and sections of departments, so that predetermined totals are independently available as a check on the statistical analysis. Machines,

not provided with typewriting equipment, which have been specially built for the purpose can be used for this work, combined with the use of some addressing machine, such as the Addressograph or the Adrema. There is so much repetitive work involved in the preparation of pay rolls that it will be found generally more economical to use this combination of machines rather than the typewriter accounting machine. However, each case must be considered upon its own merits, and sometimes a combination of calculating machines and typewriter adding machines are used.

The statistical work required by the factory in respect of labour expense will be for the purpose of costing, ascertaining labour efficiency, studying the effect of the peak production factor, and to meet the requirements of any bonus scheme that may be in existence.

The usual analysis required will be under piece-work, time-work and bonus work, which will be further analysed under direct, indirect and supervision labour, classified as to male and female, and may be required under departments, operations, processes, jobs, machine units or production units. This analysis will usually also be required as to amount, hours worked and quantities produced.

The origin of both the accounting and statistical analysis will be either a time ticket, or time-recording clock card and piece-work and job cards.

The statistical analysis will be done mainly through the costing department, either on tabulating machinery or by means of a labour distribution sheet prepared with the aid of adding and calculating machines and non-typing accounting machines. The result of this statistical analysis will then be checked in total with the accounting analysis which has been prepared independently.

There must be a proper system for making-up and paying wages and the clerks engaged in this work should not be concerned in either the accounting or statistical analysis. The payment of wages should be made from recognised pay centres. Coin counting and sorting machines will be found a useful aid to the preparation of wages for payment.

The safeguards, which are preserved against collusion and the

insertion in the pay roll of "dummy" employees, are therefore as follows :—

- (1) The reconciliation of the independent analysis for accounting and statistical purposes.
- (2) The use of time-recording clocks.
- (3) The independent payment of wages.

Time-recording clocks can now be used which are electrically controlled from a master clock, which ensures the same time being recorded throughout the factory. These clocks are not only used for timing employees in and out of the factory, but they are also employed recording actual time on jobs or processes.

Factory Overhead Charges.—With the growth of experience in costing methods has come the realisation, among other things, that careful and scientific analysis of overheads is absolutely essential to the proper ascertainment of cost.

The early methods of grouping the overhead expenses in the accounting system, and allocating them to costs on the basis of a percentage on materials or on materials and labour combined, have in general been proved not only inefficient, but entirely misleading and in many cases ridiculous.

To-day, cost allocation of factory overheads calls for analysis of expenditure by reference to departments, processes, power units, factory machines, factory area, &c. The aid of adding machines, calculating machines and, sometimes, accounting and tabulating machines, therefore, has had to be requisitioned to cope with this analytical work in order that it can be accomplished with greater accuracy, at efficient speed, and at an expense which justifies the existence of a costing system.

Mechanical methods also facilitate the reconciliation of the cost accounts with the financial accounts, when both are built up by mechanical means from the same original documents.

Purchasing Accounting and Statistics.

The method of dealing with the bought ledger or accounts payable function of accounting and the type of accounting machinery to be applied will depend, of course, upon the nature and extent of the work involved.

In considering the application of mechanical accounting to this accounting procedure, the method of dealing with invoices, the keeping of the accounts payable and method of making payments must come under review.

It has already been indicated that there should be a central department for dealing with invoices and the method of handling goods or materials received under the "apron" system has been explained. All invoices, whether for goods received or expenses, should first pass through this central department for registration.

The successful working of the accounting system with mechanical means in the accounts payable department depends to a large extent upon the prompt receipt of invoices. At one time this was an immense stumbling block, but suppliers have now, in the majority of cases, been educated to sending in their invoices upon the despatch of goods.

When the invoices are received, they should have attached to them the copy of goods received "apron." They should then be checked or marked off, as to prices, quantities and specification, with the copy order which will have been received from the purchasing department. The invoice is then ready to commence its mechanical tour.

After the foregoing procedure the invoices will be checked arithmetically and, for this purpose, if the daily number of invoices dealt with is large, it will be advisable to install a battery of calculating machines. The next procedure will be to register the invoices, and this will be done on typewriters with adding attachments, or typewriter-adding machines. The method of registration may depend upon whether the accounts payable are grouped alphabetically, geographically or departmentally, or, alternatively, the registration may be made departmentally and the invoices subsequently sorted to alphabetical ledgers for the purpose of obtaining a predetermined total for the control of the particular group of ledger accounts, the latter course being advisable.

The registration sheets will, in effect, take the place of the bound bought journal.

Expense invoices, after being classified by the internal audit department, will also be registered, a separate registration sheet being used for each class of expense.

The accounts payable invoices will be sorted and passed to the ledgers for posting to the individual suppliers' accounts by means of accounting machines and totals will be posted to the ledger control card. The ledger accounts should be kept on cards which may be contained in trays, or in a loose-leaf ledger which operates as a tray when in use, but can be closed as a loose-leaf ledger when not in use. These trays, which are mounted on trollies and, therefore, easily transportable, are kept alongside the machine operator while in use, and when not in use are generally locked in a special fire-proof strong room.

The mechanisation of the accounts payable procedure has meant the training of suppliers to receive the purchaser's statement of account instead of sending his own. This was at first a difficulty, but now suppliers readily fall in with the suggestion, as they find it of advantage to themselves.

The ledger machines will each be responsible for an alphabetical group of suppliers, and the fact that each machine will have its own control account, which will be checked independently by the group ledger total account prepared by the statistical department, renders localisation of errors much easier, particularly as each ledger will be balanced daily. This daily balance of ledgers is one of the greatest advantages of mechanical accounting, and it extends, of course, to all ledgers, whether they be accounts payable, accounts receivable, or nominal.

The question of discounts is also of great importance and provision must be made upon the ledger cards for record of discount terms, or, alternatively, a visible index should be kept alphabetically giving particulars of each supplier and terms of trading.

The rule as to payments should be that all, other than petty cash payments, must be made by cheque. There have been in existence for some time various cheque-writing devices introduced as a protection against the fraudulent use of cheques. From these has developed the pin-point cheque-writing typewriter, which not only types the cheque with the same protection, but at the same time, and made as copies of the cheque itself, prepares an authorisation sheet giving authority to the bank to meet the cheques mentioned therein and also prepares a

statement in duplicate which becomes the accounts payable cash book, the duplicate being used as the cash posting medium to the ledger.

The authorisation sheet, which can contain particulars of at least fifty cheques, is signed by the executives in the same manner as they would have signed the cheque before the introduction of this system, the cheques themselves usually bearing facsimile signatures of two officials of the concern.

It is obvious that the saving of executive time in this direction is no mean consideration, for, in place of every signature required formerly, at least only one in fifty is now required.

From the point of view of safety the authorisation sheet, which is despatched to the bank at the same time as the cheques are posted, ensures that no cheques are met except those officially drawn and authorised.

In addition to the accounting detail dealt with by office machinery in connection with accounts payable, there is a great deal of statistical analysis to be mechanically performed. This statistical work is required for purposes of unit stock control, control of departmental commitments and the purchasing controller may require statistical information as to prices and quantities purchased in particular markets, or from particular suppliers. This work is sometimes done on typewriter accounting machines and sometimes on tabulating machines, where these latter machines are already in use on other work.

The safeguards still retained in mechanisation in connection with the purchasing accounting branch of the accounting function, therefore, are as follows :—

- (1) The ledger machine operators are not allowed to handle cash, and the cashiers are prohibited from dealing with ledger machines or accounts.
- (2) Group ledger total accounts are kept by the statistical department as a check upon the group ledger control accounts kept by the machine operators.
- (3) The basic documents used for both accounting and statistical purposes are the properly registered documents of original entry.
- (4) A more efficient check on goods received is provided.

Sales Accounting and Statistics.

There is, possibly, greater scope for mechanisation in connection with sales accounting and statistics than is the case with any other branch of the accountancy activities. At all events it is this branch of accounting which usually receives first attention when mechanisation has been decided upon.

The accounting field covers invoicing or billing, sales ledgers or accounts receivable, cash receipts and credit control, in all of which there is room for mechanisation or some form of labour-saving device, such as the visible index.

Accounting analysis usually requires the sales to be dissected into wholesale, retail, cash, credit, mail orders, and export. Also, further accounting divisions have to be made to meet hire purchase, instalment sale, and sale or return business, and to deal with returns and allowances and cash discounts.

In addition to the foregoing, the statistical sales dissection may have to be made departmentally, geographically, over commodities, to group ledgers, to sales people for commission purposes, and for stock control requirements. Usually this analysis is done by the statistical department independently of the accounts receivable department, and provides, among other things, an independent check on that department by the preparation of sales ledger total accounts for each group of ledgers, which are agreed daily with the control accounts of the various group ledgers.

Further analysis of a statistical nature may be required for the purpose of ascertaining velocity of turnover in certain districts or by particular agents, for calculating royalties payable, for providing information as to deliveries by districts, for the purpose of testing the pulling power of advertising—either by reference to the form of advertising or by district, and for the purpose of ascertaining the efficiency of salespeople. Most of this analytical information will be required in quantities and types of commodities as well as in amount.

It is obvious, therefore, that without mechanisation, in a business of any size, it would be impossible to cope with the work entailed in sales accounting and statistical analysis, except at enormous expense, rendering much of the work itself not worth the effort.

The basis of the analysis and posting media will be the documents of original entry, such as the sales dockets, duplicate cash receipts, returns vouchers, &c. The documents of original entry will be numbered and, in order to ensure that all dockets are accounted for, an adequate system of registration must be in use and a proper system of filing installed, so that all dockets may be readily available for reference when required subsequent to posting.

It may be found necessary, on the grounds of economy and/or convenience, to have the documents of original entry prepared by hand, e.g. where the business is engaged in retail distribution, while in other cases, where sales are not made over the counter, it will in the main be more expeditious to have them typed on accounting machines specially built for the use of fanfold or continuous stationery.

In general, the machines required to meet the needs of sales accounting and statistics will be adding, calculating, billing or invoicing, and ledger-posting machines. In addition, or alternatively, according to the circumstances, cash registers may be brought into use for dealing with cash receipts, and there are special types of accounting machines suitable for hire-purchase and hotel accounting.

In some concerns tabulating machinery is employed throughout the accounting system, while in other cases accounting machines are now used which combine the functions of the billing and ledger-posting machines.

The adding and calculating machines are more particularly employed in the statistical and internal audit sections of the accounting department in checking calculations on original documents, not already prepared on accounting machines, and analysing sales to salespeople and group ledger total accounts.

The main safeguards preserved in the mechanical sales accounting procedure are as follows :—

- (1) The daily check on the group ledger control accounts by the independent sales ledger total account prepared by the statistical section.
- (2) The provision that group ledger machine operators are not allowed to handle cash and cashiers are not permitted to touch ledger accounts.

- (3) All cash received must be banked daily.
- (4) The basic documents used for both accounting and statistical purposes are the properly registered documents of original entry.

General Accounting.

The nominal and private ledgers should contain within themselves all the necessary data for the extraction of a trial balance. Whether or not mechanisation should be applied to these ledgers will depend upon the circumstances of each business and the extent to which analysis of nominal and private ledger accounts is required, but whether these ledger accounts are written up by hand in loose-leaf or bound ledgers, or are prepared on the card or loose-leaf principle by machinery, it is essential that they should be so arranged and classified as to provide the greatest facility for the preparation of the periodical manufacturing, trading and profit and loss accounts and the balance sheet.

The nominal and private ledger accounts will be written up from the main cash book, the expense summary cards prepared in the central invoicing department, and from the purchases and sales ledger total accounts prepared in the statistical section, or, alternatively, a further check may be provided by building up these total accounts independently in the ledgers from the merchandise summary cards, cash analysis, &c. In addition, it will probably be necessary to keep analytical journals for the nominal and private ledgers to take care of extraordinary items outside the ordinary accounting routine.

MECHANISATION AND THE AUDITOR

It has already been emphasised that no alteration in method of accounting should be permitted without prior consultation with the auditor. The main reason for this is to give the auditor an opportunity of satisfying himself as to whether or not he can adjust his audit programme to meet mechanical accounting conditions without violating the duties of his office.

Apart from mechanical accounting, in the past the auditor frequently has had to adjust his programme and requirements to meet changing accounting conditions. At one time he insisted upon all

items not passing through any other book of original entry being journalised. The business need for the speedy production of audited accounts, however, persuaded him to modify this demand with regard to the journalisation of unexpired payments and accrued charges, which were then dealt with by bringing down such items in the particular ledger account concerned without being passed through any book of original entry. Again, when business transactions were on a smaller scale than at present, he considered it his duty to check in detail all transactions of whatever nature entered in the books of account, but with the subsequent introduction of ledger total or adjustment accounts he displaced much of this detailed checking by relying upon a system of check by tests.

In examining mechanical methods, therefore, from an audit point of view, the auditor must be prepared to make necessary adjustments in his programme to meet business requirements, provided he can satisfy himself by adequate tests that—

- (1) All transactions are properly recorded.
- (2) All transactions are properly authorised.
- (3) The usual accountancy safeguards have been preserved and the possibility of collusion reduced to its minimum.

In addition, he should satisfy himself as to the reliability of the machinery itself and that the method of handling documents of original entry does not prevent him tracing the records right through the accounting system if he so desires.

Mechanisation has greatly reduced the human element in accounting, but it has by no means eliminated it. The auditor, therefore, should carefully examine those parts of the mechanical system where the human factor comes most into play and see that the system of internal check in use to meet this condition is adequate. In this respect he may be satisfied that, in addition to his general audit tests, he can rely to a great extent upon the checks given by the machinery itself, such as proof sheets, audit strips and the working to independent predetermined totals and the further check provided by a proper system of control accounts.

The general system of internal check and methods of allocating expenditure must also receive the careful attention of the auditor.

Mechanical accounting has undoubtedly decreased the detailed audit work of the professional accountant, but, on the other hand, it should have increased the work in his capacity of accountant if he is really alive to the possibilities of office machinery, for his services will be called upon both to advise as to suitable machinery and to devise suitable mechanical accounting systems. This has been recognised, at least, by some of the larger firms of professional accountants, who now employ mechanisation experts on their staff.

The need for co-operation with the professional accountant has been recognised by the manufacturers of accounting machines, who in many cases employ qualified accountants on their selling staffs which should ensure a proper appreciation of the auditor's viewpoint.

Accounting machinery has been developed to such a high state of efficiency that auditors, who are familiar with its use, rarely have any auditing objections to offer against its employment at the present time. In this respect the following typical replies to a questionnaire on the subject received from two of the leading manufacturers are interesting :—

(1) " It may properly be said that the objections raised by auditors as a rule are mainly due to their very natural and proper conservatism, as well as to the fact that only in recent years have any great number of the profession become in any degree familiar with the extent to which machines can actually aid in the solution of their problems. The increased interest which members of the profession have shown in machines and machine methods in recent years is certainly bringing about a more favourable attitude on their own part toward office mechanisation, but also a concurrent improvement in the methods of application."

(2) " The majority of objections that arise in the minds of accountants and auditors who are not familiar with machine methods, can be traced to the necessity of doing certain things in certain ways—under the pen and ink system. Long years of experience of pen and ink methods have taught accountants and auditors that certain practices are essential for checking and

proving all bookkeeping work that is dealt with by the human hand and brain.

“ It is easy to appreciate that an accountant or auditor who has little or no acquaintance with machine methods finds it extremely difficult to understand how certain of these established practices can be entirely dispensed with under the machine method, with any degree of safety.

“ Nevertheless, it is a fact that in an efficient machine system—with its automatic mechanical proof of every stage of the routine right up to the final balance—the majority of the objections visualised simply do not arise in actual practice. It is a matter of obtaining a complete picture of the whole routine, rather than of looking at one particular phase of it in the light of past experience.

“ Actual inspection of an efficient machine installation will quickly dispel the doubts of any accountant or auditor, who is concerned about what will prove to be the imaginary drawbacks of the machine system.”

There are still, however, some professional accountants who find it difficult to adjust themselves to mechanical methods, but as experience of mechanisation grows this difficulty tends to become eliminated. The prejudices against the use of loose-leaf or card ledgers and the absence of journalised entries are fast disappearing with the present successful use of mechanical methods in the largest and most reputable concerns in almost every line of business. It seems, therefore, that the time has arrived when greater attention should be paid to the subject of mechanical accounting in the professional examination syllabus and arrangements made for lectures and machine demonstrations for accountant students, so that the future generations of professional accountants will secure and maintain a status in this ever-widening field of accounting procedure, such as they have hitherto enjoyed in past accounting practice.

INSTALLATION OF MECHANICAL ACCOUNTING

In order to obtain the utmost efficiency from accounting machines it is absolutely necessary to study carefully the requirements for its

proper installation, for, sometimes, the machines are blamed for faults arising from the lack of attention to what are thought to be obvious details.

The first essential is that the accountant must carefully study, in collaboration with the auditor, any alterations required in the accounting system to meet the installation of mechanical methods and also to consider the effect of such changes on business routine.

It will be found generally that few accounting machines can be made to pay their way unless they are employed almost to full capacity. To enable this to be accomplished, the work of the machines must be carefully planned and allotted by the accountant, who will find the machine manufacturers, or their selling organisations, eager to give him the utmost help in this direction.

Accommodation should be provided which will facilitate the full employment of the machinery by the centralisation of the work. The lay-out of the accounting machinery itself should be so arranged that the work flows freely from one operation to the next, so that the amount of running about by operators and others is reduced to a minimum.

Careful attention must be given to the provision of adequate lighting arrangements, both daylight and artificial, which latter should be so distributed as to give a proper diffusion of light, thus avoiding what might otherwise be a serious handicap on the machine operator. The sitting posture of the operators should also be studied to provide the maximum avoidance of fatigue.

The noise factor, which is ever present when machinery is employed, should also be carefully considered and, if deemed necessary, arrangements should be made to dampen this down as much as possible by acoustic treatment of ceilings, floors and walls, &c. The leading makes of acoustic materials are Acousticos, Celotex, the Johns-Manville System, May's Acoustic Products, Newalls Asbestos Products and Slagbestos. Machine manufacturers have given quite considerable study to this problem and in many cases have made great improvements in the machines themselves from the standpoint of noise reduction.

The use of machinery in accounting requires a higher standard of



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[Photo by Romney, Glasgow]

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intelligence and alertness in the machine operators than is usually required in clerks engaged in the ordinary routine of bookkeeping. The accountant, therefore, should ensure that his operators have had sufficient training before he installs his machinery. Here again most machine manufacturers, or their selling agents, will give the utmost help and not only train an adequate number of machine operators, but provide supervision for some time after installation.

Where machinery is used to any great extent, proper provision should be made for its upkeep and supervision, so that any initial difficulties can be promptly dealt with. Where the machines are operated by electrically driven motors, care should be exercised in providing safeguards, by supervision or otherwise, to ensure that the electric current is not left switched on when the machine is not in use.

Installation difficulties generally arise from lack of co-operation of the staff, inadequate planning and the necessity sometimes of running the old and new systems together for a period. These difficulties, if they do arise, are soon overcome with patience, determination, and the unstinted assistance generally given by the manufacturers.

ACCOUNTING AND CALCULATING MACHINERY

We have thus examined the growth in analytical work to meet management demands, the higher status of the accountant, the need for a proper classification of accounts, the general application of machinery to the accounting and statistical system, the relation of mechanisation to the auditor, and the precautions to be taken in planning the installation of machinery. It remains for us now to consider the factors governing the choice of machinery and the different types of machines available.

CHOICE OF EQUIPMENT

There is now on the market an almost unlimited range of equipment for mechanical accounting and calculating, in each class of which there are different types, with special advantages of their own and varying degrees of efficiency. It is not within the scope of this paper, however, to express any preference for any particular type of

accounting or calculating machine, as this can be done only by reference to the varying accounting needs of each business. It therefore is possible to give only a guide to the general factors which should influence the choice.

All accounting machines are equipped with features that practically produce the same accounting or statistical results, and the relative merits of the various classes of machines will depend on the method employed to obtain these results.

The main considerations in the choice of accounting, statistical, or calculating machines will be, therefore :—

- (1) Speed and simplicity of operation, in this respect it will also be necessary to study the merits or demerits of mechanically and electrically operated machines, to distinguish between machines with and without typewriter attachments and the difference in machines upon which the operator's work is visible or non-visible. The number of machine operations necessary to complete an accounting or calculating record should also be examined.
- (2) Accuracy and method of proof.
- (3) Flexibility, that is, capability of being used for varying accounting operations.
- (4) Space required for efficient working of machines.
- (5) Cost, that is, the expense in relation to the advantages to be obtained from the use of a particular type of machine, not merely from the point of view of savings in expense, but also in the provision of greater accounting efficiency.

In comparing the different makes of accounting machines, special consideration should be given to keyboards, carriages and method of accumulation.

The four main types of keyboard are the full or multifigure visible keyboard, ten-key keyboard, twelve-key keyboard and the typewriter keyboard.

The usual types of carriages are the manually tabulated, key tabulated, visible automatic and blind automatic. Manually tabulated carriages, however, are not found on the latest machines, as they are generally admitted to be too slow in operation.

The methods of accumulation are register accumulation and adding machine accumulation. In the former case totals are cleared by copying them and subtracting in the machine, while in the latter case the machine can be cleared by depression of a motor bar.

Other important matters to consider before the choice of machine is finally made are method of stationery feed, automatic printing of ciphers and punctuation, split or unlimited platen devices, cross-footing totalling devices, method and proof of pick-up of old balances, capacity of machine for storing totals, method of transfer of totals from one register to another and manufacturers' service arrangements.

Each type of keyboard, carriage, method of accumulation, &c., must be considered by reference to the particular work for which the machine is required. The main points to be watched are speed of operation and degree of effort required by the operator.

The most important guide in making a choice of machine is the demonstration of the machine itself, which will be given freely by the various manufacturers. The demonstrations, however, if possible should be obtained on the actual work for which the machine is being considered, so that an exact comparison of results may be made.

DIFFERENT TYPES OF MACHINES AVAILABLE

In order to make this paper of the utmost use to accountants, it is necessary to detail, as far as possible, some of the different types of adding, calculating and accounting machines at present on the market.

It will not be possible, of course, to go into the mechanical operations of all these machines, or even to detail the specialities of each make, and for that reason the names and addresses of the principal manufacturers or agents are given as an addendum, so that accountants can arrange for demonstrations at will.

We can deal here only with the special features of standard machines, but the leading manufacturers of accounting machines usually undertake, when necessary, and within limits, to adapt their standard machines to the special requirements of any particular business or accounting procedure.

For our present purpose we will divide the machines for consideration under the following general heads :—

- (1) Adding and calculating machines.
- (2) Accounting machines.

There are, of course, numbers of other machines and gadgets in use in the office, such as duplicating, franking, dictating, letter opening, addressing, endorsing and signature machines, &c., but which do not come within the scope of a paper on mechanical accounting.

The order in which the various makes of machines are mentioned is purely alphabetical and must not be taken as suggesting any order of preference, which can be decided only in relation to the actual work for which the particular class of machine is required.

Adding and Calculating Machines.

The difference between adding and calculating machines lies in the fact that the former machines, although in some cases built to subtract and multiply by adding methods, are primarily built for pure addition work, while the latter machines perform the functions of addition, subtraction, multiplication and division.

Both classes of machines, which are made in portable, desk and stand models, may be operated either by hand, electrically, or in some cases by both methods and may be listing or non-listing machines. In addition, duplex mechanism is fitted to many machine models, which enables two independent sets of figures to be listed and added simultaneously. This feature is especially useful for trial balance purposes, as it permits the machine to accumulate separate totals of debit and credit balances concurrently. Nearly all makes can be supplied for £ s d or decimal additions and calculations and there are machines available for calculation of weights and measures.

Adding machines are generally of the visible keyboard type and are in three classes, standard keyboard, twelve-key keyboard and ten-key keyboard. They are nearly all fitted with total, sub-total, non-add, repeat and error control keys and the listing machines have usually a non-print lever. Adding machines are supplied with, or without, direct subtracting device and are generally designed to include multiplication.

Calculating machines can be obtained with either fully automatic or semi-automatic mechanisms for multiplication and division.

The best known makes of adding machine grouped according to style of keyboard are as follows :—

Standard keyboard.

Addo, Barrett, Burroughs, Comptometer, Direct, Monroe, National and Victor.

Twelve-key keyboard.

Dalton, Remington, Sundstrand and Monarch.

Ten-key keyboard.

Odhner.

Calculating machines are of three types, namely, standard keyboard, barrel and slide setting, the principal makes of which are as follows :—

Standard keyboard.

Archimedes, Burroughs, Comptometer, Hamann, Madas-Portable, Marchant, Mercedes-Sterling, Millionaire, Monroe and Muldivo.

Barrel type.

Brunsviga, Lusid, Marchant-Junior, Mercedes-Melitta, Mira and Odhner.

Slide Setting type.

Mercedes-Euclid, Tim and Unitas.

Some of the standard keyboard type of calculating machines mentioned above also combine the slide setting operation.

Accounting Machines.

There is an almost unlimited choice of accounting machines now on the market, each make capable of obtaining similar accounting results by differing methods and, therefore, with differences as to speed of operation, flexibility, methods of proof and expense.

The accountant must consider, however, the different types in the light of the work for which the machine is required and no general recommendation can be given within the limited scope of a paper of this character. For example, for hire-purchase or hotel accounting the National 2000 or 3000 class machines may be found to be the most suitable, while for preparation of payrolls and similar work

Burroughs or Smith Premier machines may possibly be used to greater advantage. Again, in engineering works, the punched card machines of Hollerith or Powers may be required.

The choice of machine all depends, therefore, on the nature and volume of the work involved and the limit of initial expense. The points to watch when comparing the merits of various makes have already been considered.

In nearly all cases, accounting machines can be had either hand or electrically operated and many of them are fitted with cross totalling devices.

While there are differences in construction between different makes within each classification, the following are the main classifications of machines :—

(1) *Typewriters with adding box or register attachment.*

Typewriters of nearly all makes are built for invoicing or billing, with special attachments to take fanfold, interfold and continuous stationery. In addition, typewriters with adding box attachments, which are detachable, are used for billing, ledger posting, cheque writing and cash accounting under the system that has already been explained when dealing with accounts payable.

This type of machine is built for vertical or cross totalling as required.

Some machines of the vertical type are capable of giving up to thirty vertical totals and in addition may be fitted with a dual cross totalling mechanism, which gives two horizontal totals which can be used for sterling, sterling and currency, units and currency, or units and sterling.

Although these accounting machines can very often be usefully employed in the general scheme of mechanisation for large concerns, much greater scope will be found for their employment in the smaller business. They can be used either as accounting machines with full typing facilities, or as ordinary typewriters, although it is not economical to use the machine in this latter capacity.

The principal makes of this type of accounting machine are Remington, Smith Premier and Underwood.

(2) *Flat-bed type.*

Machines of the flat-bed type are similar to the typewriter class,

but instead of the printing being done on the usual typewriter carriage the machines are mounted upon a flat platen or table, upon which the accounting forms are placed and operated upon by the typewriter, which moves automatically to each writing position up and down the table on ratchets. Machines of this type are built for all kinds of accounting work and the principal makes are Elliott-Fisher and Mercedes.

The National also have a flat-bed type of machine, not of the typewriter class, which performs four operations simultaneously.

In addition to the above, Elliott-Fisher still build and market a flat-bed type of machine for working on bound books, but this is a clumsy method of accounting.

(3) *Adding machine type.*

This type of machine, which has for its basis the adding-subtracting machine, is built either with or without typewriter combination, while other machines in this class have the printing of special words such as "Goods," "Cash," "Returns," &c., provided in the machine itself.

These machines are also supplied with an automatic dating device and they are suitable for all kinds of accounting and statistical work. There are special machines for dealing with cash, hire-purchase, public utility, bank and all classes of specialised work. There are also machines in this class for cheque and receipt writing, cash accounting and the preparation of dividend statements and warrants.

The accounting machines of this type are made with two different styles of keyboard, the visible standard adding machine keyboard and the twelve-key keyboard.

The principal makes with the standard keyboard are Burroughs and National, who both have an exceedingly fine and efficient range of this class of machine.

The principal makes of the twelve-key keyboard machines are the Dalton and Sundstrand, which make a speciality of the touch operation, that is to say, operators are trained to work by touch without watching the keys. The advantages of this method in ordinary typewriting work are well known and the use of touch operation in figure work by efficient operators may be of equal value.

Machines of this twelve-key class do not, however, automatically print cyphers and, when it is considered that it is estimated that from 30 per cent. to 50 per cent. of all figure work is made up of cyphers, it will be realised that the lack of this feature is a distinct handicap.

The principal difference between the typewriter-adding machine combination and the typewriter with adding box attachments, previously mentioned, lies in the fact that the former machines were built primarily as adding-subtracting machines, the typewriter equipment having been added subsequently, while the latter machines were built for use as typewriters with the subsequent addition of adding boxes, or totalisers.

(4) *Punched card or tabulating system.*

The punched card, or tabulating, system is one which has come more to the front in recent years. It is more particularly suitable for businesses in which there is a great deal of analytical work to be done under many classifications, because this system is expensive, from the point of view of either capital outlay or rental and therefore requires to be worked to full capacity. It differs entirely from other accounting machines. The principal difference is that it is not only a machine, but a system.

The basis of this system is provided by cards punched with the data taken from the documents of original entry, the punched holes supplying the means of selection for sorting and tabulating. The system consists of four operations, punching, automatic verifying, sorting and tabulating. All work becomes mechanical after the original punching and verification operations, which are the only hand operations, and thereafter the human element is reduced to a minimum. Gang punches are also supplied when required for punching numerous cards with the same information at one operation.

The two makes of this class of accounting machinery, which is used in some businesses throughout the whole accounting and statistical system, are Powers-Samas and Hollerith.

In the case of Hollerith the punching, verification and sorting operations are standard to all installations, but there are varying types of tabulators as follows :—

Hollerith Non-Listing machine, which merely totals the cards in

counters or registers, leaving the operator to record by hand the totals shown on the counters.

Hollerith Printing and Listing machine, which either lists the information contained on every card and accumulates totals and prints them when required, or it will merely print totals for groups of cards. This type of machine is generally used for statistical and costing work.

When Hollerith machines are applied to billing, ledger posting or other accounting work, two fitments are attached to the tabulator, one for automatic subtraction and the other a printing device for describing the items. An automatic statement device is also fitted to the ledger posting machines to cope with continuous fanfold stationery.

Powers-Samas have a similar range of machines to Hollerith, the main difference between the two being that, while Hollerith tabulators are operated electrically by plugs which can be adjusted at will, Powers tabulators are mechanically operated by pre-determined pin boxes.

Hollerith tabulating speed is 9,000 per hour, while that of Powers varies from 4,800 to 7,000 per hour, according to the class of work to be operated. The sorting speeds of the two systems are the same, being 24,000 per hour.

Powers also make a smaller scale machine, which is called " Powers Four," suitable for accounting work in smaller concerns.

Hollerith machines, except punches, cannot be purchased ; they can only be rented, while those of Powers cannot be rented but must be purchased either outright or on hire-purchase.

The Paramount system, although not an accounting machine system, also provides for punched cards and sorting by needle, but no provision is made for tabulation. This system is useful when the tabulating work is so small in volume that it can be accomplished better by hand, or in conjunction with the use of adding or calculating machines.

(5) *Campos type.*

The Campos machine, which is a new machine of a semi-tabulating type, in a class by itself, has a double entry device and 1,000 registers. It will accumulate amounts in any one of these registers for any

length of time. It is not so flexible as some of the other makes of machines, but has great possibilities and is worth investigation.

The main features of this machine are that it will :—

- (a) Automatically pick up and print the old ledger balance.
- (b) Print debits and credits automatically in their correct columns.
- (c) Automatically compute and print the new balance.
- (d) Stores such new balance.
- (e) Automatically accumulate postings for double entry purposes.
- (f) Automatically give a trial balance by the setting of a lever.

This machine will probably be found most useful for stock control work, or expense analysis. In view of its lack of flexibility, it is, however, an extremely expensive machine.

(6) *Copying type.*

A German machine which has just been introduced on the British market is also in a class by itself and is styled “Ormig.” It has been in use in Germany for some time with success, but is little known in this country.

The “Ormig” is in fact a copying machine. The original entries are made on a sheet of paper called the “Master” with a sheet of Ormig Carbon placed behind it. In this manner a negative or mirror print impression is obtained and at the same time, and by the same operation, a duplicate master is prepared which becomes virtually a book of original entry when used for accounting purposes.

The master can be handwritten, typed, or prepared on any accounting or tabulating machine and once it has been checked it is claimed that the possibility of subsequent error is eliminated.

The pick-up of the master sheet is automatic after placing it on the Ormig machine, which is a flat table with a rotary copying device and similar in appearance to many ordinary duplicating machines. The ledger cards, dockets, or records are fed into the machine by hand and each posting is effected by the depression of a treadle, which operates the rotary drum upon which the master has been secured. Alignment is instantaneous and registration is automatic.

The Ormig method can be applied to every class of accounting and statistical requirement of a posting or a copying nature. There is, however, no adding or calculating device attached to the machine

and all postings are made in detail, which somewhat limits the scope of the machine.

CONCLUSION

In conclusion it must be emphasised that, if mechanical accounting is to be employed with full benefit, we must realise not only the need for the production of adequate data, but also the even greater necessity for the proper arrangement of that data and its intelligent interpretation. In this latter sphere the professional accountant plays an all-important part by directing investigation into its proper channels through the medium of his detached view of the business as a whole.

There is no doubt that mechanical accounting has not only come to stay, but will continue to grow and as time passes will become more and more simplified in operation. As professional accountants, we must be fully alive to this fact and take it into full consideration when devising or overhauling accounting systems.

ADDENDUM

<i>Type</i>	<i>Name and Address of Maker (or Agent)</i>	<i>Trade Name</i>
ADDING MACHINES	Block & Anderson, Ltd., Brunsviga House, 3 Snow Hill, London, E.C.1.	Victor
	Burroughs Adding Machine, Ltd., 136 Regent Street, London, W.1.	Burroughs
	Felt & Tarrant, Ltd., Aldwych House, Aldwych, London, W.C.2.	Comptometer
	Merkham Trading Co., Ltd., Bush House, Aldwych, London, W.C.2.	Monroe
	Muldivo Calculating Machine Co., Ltd., 49 Queen Victoria Street, London, E.C.4.	Barrett
	National Cash Register Co., Ltd., 225 Tottenham Court Road, London, W.1.	National

MECHANICAL ACCOUNTING

<i>Type</i>	<i>Name and Address of Maker (or Agent)</i>	<i>Trade Name</i>
ADDING MACHINES	Remington Typewriter Co., Ltd., 100 Gracechurch Street, London, E.C.3.	Dalton
	Smith Premier Typewriting Co., Ltd., • 4 St. Paul's Churchyard, London, E.C.4.	Dalton
	Underwood Elliott Fisher, Ltd., Bush House, Aldwych, London, W.C.2.	Sundstrand
	Gilbert Wood (Arithmetical Machines) 75B Queen Victoria Street, [Ltd., London, E.C.4.	Addo Direct Monarch Odhner
CALCULATING MACHINES	Block & Anderson, Ltd., Brunsviga House, 3 Snow Hill, London, E.C.1.	Archimedes Brunsviga
	J. C. Burnham & Co. (Gt. Britain) Ltd., Bush House, Aldwych, London, W.C.2.	Marchant
	Burroughs Adding Machine, Ltd., 136 Regent Street, London, W.1.	Burroughs
	Felt & Tarrant, Ltd., Aldwych House, Aldwych, London, W.C.2.	Comptometer
	Mercedes Sterling Bookkeeping Calculating Machines, Ltd., 51-54 Gracechurch Street, London, E.C.3.	Mercedes- Melitta Mercedes- Sterling Mercedes- Euclid
	Merkham Trading Co., Ltd., Bush House, Aldwych, London, W.C.2.	Monroe
	Muldivo Calculating Machine Co., Ltd., 49 Queen Victoria Street, London, E.C.4.	Muldivo

<i>Type</i>	<i>Name and Address of Maker (or Agent)</i>	<i>Trade Name</i>
CALCULATING MACHINES	George Spicer, Market Place, Brentford, Middlesex. Gilbert Wood (Arithmetical Machines), 75B Queen Victoria Street, [Ltd. • London, E.C.4.	Tim Unitas Mira Hamann Lusid Madas Millionaire Odhner
ACCOUNTING MACHINES	Block & Anderson, Ltd., Brunsviga House, 3 Snow Hill, London, E.C.1. British Tabulating Machine Co., Ltd., Victoria House, Vernon Place, Southampton Row, London, W.C.1. Burroughs Adding Machine, Ltd., 136 Regent Street, London, W.1. Mercedes Sterling Bookkeeping Calculating Machines, Ltd., 51-54 Gracechurch Street, London, E.C.3. National Cash Register Co., Ltd., 225 Tottenham Court Road, London, W.1. Powers-Samas Accounting Machines, Aldwych House, Aldwych, [Ltd., London, W.C.2. Remington Typewriter Co., Ltd., 100 Gracechurch Street, London, E.C.3. Smith Premier Typewriting Co., Ltd., 4 St. Paul's Churchyard, London, E.C.4. Underwood Elliott Fisher, Ltd., Bush House, Aldwych, London, W.C.2.	Ormig Hollerith Burroughs Moon- Hopkins Mercedes National Powers Campos Remington Smith Premier Elliott Fisher Sundstrand Underwood

<i>Type</i>	<i>Name and Address of Maker (or Agent)</i>	<i>Trade Name</i>
CASHIER MACHINES	Brandt Automatic Cashier Co., Ltd., Washington House, 40-41 Conduit St., London, W.1.	Brandt
	Burroughs Adding Machine, Ltd., 136 Regent Street, London, W.1.	Burroughs
	National Cash Register Co., Ltd., 225 Tottenham Court Road, London, W.1.	National
CHEQUE AND RECEIPT WRITING MACHINES	Burroughs Adding Machine, Ltd., 136 Regent Street, London, W.1.	Burroughs
	National Cash Register Co., Ltd., 225 Tottenham Court Road, London, W.1.	National
	Remington Typewriter Co., Ltd., 100 Gracechurch Street, London, E.C.3.	Remington
	Smith Premier Typewriting Co., Ltd., 4 St. Paul's Churchyard, London, E.C.4.	Smith Premier
WAGES PAYING MACHINE	Brandt Automatic Cashier Co., Ltd., Washington House, 40-41 Conduit St., London, W.1.	Brandt
ACOUSTIC MATERIALS	Celotex Co. of Great Britain, Ltd. 324-6 Australia House, Strand, London, W.C.2.	Celotex
	H. W. Cullum & Co., Ltd., 50-52 Britannia Street, King's Cross, London, W.C.1.	Acousticos Johns- Manville System
	May Acoustics, Ltd., De Burgh Road, Wimbledon, London, S.W.19.	Maycoustic Sabinite
	F. McNeill & Co., Ltd., 52 Russell Square, London, W.C.1.	Cabot's Quilt Slagbestos

<i>Type</i>	<i>Name and Address of Maker (or Agent)</i>	<i>Trade Name</i>
ACOUSTIC MATERIALS	Newalls Acoustic Products, Ltd., Asbestos House, Southwark Street, London, S.E.1.	Newalls Asbestos
ADDRESSING MACHINES	Addressall Machine Co., 96 High Holborn, London, W.C.1. Addressograph-Multigraph, Ltd. 73-78 High Holborn, London, W.C.1. Adrema, Ltd., 136 Regent Street, London, W.1. Hayward Co., 62 Red Lion Street, London, E.C.1. Roneo, Ltd., 5-11 Holborn, London, E.C.1.	Addressall Addresso- graph Multigraph Adrema Addressamite Elliott Roneo
TIME RECORDING CLOCKS	Blick Time Recorders, Ltd. 174 Gray's Inn Road, London, W.C.1. Gledhill-Brook Time Recorders, Ltd., Empire Works, Huddersfield. International Time Recording Co., Ltd., 112 Strand, London, W.C.2. Magnet Time Co., Ltd., 5 Tothill Street, Westminster, London, S.W.1. National Time Recorder Co., Ltd., 227 & 228 Blackfriars Road, London, S.E.1.	Blick Gledhill- Brook International Bundy Dey Time Magnet Stromberg National
VISIBLE CARD INDEX SYSTEMS	Carter-Parratt, Ltd., 16 Victoria Street, London, S.W.1. C. W. Cave & Co., Ltd., 45 Farringdon Road, London, E.C.1.	Bizada Cavedex

<i>Type</i>	<i>Name and Address of Maker (or Agent)</i>	<i>Trade Name</i>
VISIBLE CARD	Copeland-Chatterson Co., Ltd.,	Cope-Chat
INDEX	Exchange House, Old Change,	
SYSTEMS	London, E.C.4.	
	Index, Ltd.,	Harcodex
	312 Thames House, Millbank,	
	London, S.W.1.	
	Library Bureau, Ltd.,	Kardex
	1 Leadenhall Street,	
	London, E.C.3.	
	Shannon, Ltd.,	Acme
	Imperial House, 15-19 Kingsway,	
	London, W.C.2.	

DISCUSSION

THE CHAIRMAN : The paper for this session is by Professor W. Annan, Professor of Accounting and Business Methods, Edinburgh University, the subject being : "Accounting as an Aid to Commerce."

I will now call upon Professor Annan to introduce his paper.

PROFESSOR W. ANNAN, C.A. : Mr. Chairman, my Lord President, ladies and gentlemen, the subject which I have the honour to present to you is a wide one ; it is so wide that only a small part of it can be dealt with in a paper of this kind. I have therefore limited my remarks to a few matters which I thought might be of especial interest to a body such as this. What I have written is probably familiar to most of you already, and if some of my observations are severely simple and rather obvious I claim your forbearance for mentioning them. I do so on the ground that there is a danger in accepting bygone rules and practices without inquiring as to their suitability to modern conditions, and that simple matters are apt to be overlooked in the course of considering those of a more abstruse and complex nature.

My main theme is the importance of periodical business statistics, and the planning of the system of bookkeeping so as to provide the necessary data for their preparation.

In large concerns, but not yet in the medium-sized and small businesses, it is generally recognised that the executive must be provided with appropriate statistics at short intervals during the year ; that it is imperative to know how the business is progressing throughout the year, and that it is inexcusable in these days of advanced accounting to rely only on the annual balance sheet and profit and loss account to disclose the trading results.

It is the role of the accountant to provide the proper records and, by arrangement with the executive, the appropriate forms of statistics.

I am submitting that in three different ways the accounting profession is being drawn upon to supply the needs of commerce and industry in this respect : (1) by the qualified accountant who adopts business as a career ; (2) by the auditor ; and (3) by the advisory accountant.

The articled clerk's education and training especially qualify him for the higher accounting posts in industry and commerce. The theoretical knowledge of bookkeeping he acquires in studying for his examinations, and the experience gained in examining the books of different kinds of businesses during his apprenticeship, give him a different outlook from those whose experience is confined to a specific business or a certain kind of business. The adaptive faculty is developed by such experience, and facilitates the planning of a system of bookkeeping to produce any given data automatically and without delay. It is essential, of course, that the knowledge of modern bookkeeping methods and recording appliances should be extensive and up to date ; it is imperative that it should include the latest improvements in methods of costing. In short, in addition to preparing the annual accounts for the auditor, the accountant in business, in collaboration with the executive, should devise such periodical statistics as will be of real assistance to those responsible for the management, and so allow them to devote their whole energies to the practical affairs of the business.

In my paper I give a few suggestions of statistical statements of a serviceable nature, ranging from a simple comparison of sales to the more complicated but exceedingly useful programme consisting of a standard or budget of performance and short-interval comparisons of same with the actual. No generalisation on statistical forms can be made. Each business has its own peculiarities and needs. The general aim should be to show the executive how the business is progressing during the year and whether it is improving or not on past performances or on the performance that has been budgeted for.

Under the heading of Service for Auditors, I am asking you to consider whether accountants acting as auditors are not inclined to think too much about the strictly legal aspect of their duties and the limitation of their liabilities, and missing opportunities of furthering their clients' interests by offering to assist them in providing suitable accounts and periodical statistical records for the guidance of the management. In the case of large concerns with expert accountants on the staff, such an offer may not be necessary, but there are many businesses where the auditor's help in this way would be of great value ; and my experience is that, if properly made, the offer is appreciated and readily accepted. If the intervention of the auditor in this respect was more general, there would be fewer surprise results at the end of the financial year and less unintelligent and stupid cutting of prices. The estimates and probabilities on which all

business proceeds would have the solid basis of past results as a guide, and there would be less of the haphazard rule-of-thumb practice which so often ends in disaster.

I emphasise this matter because it is my experience, and must, I am sure, be yours also, that old-fashioned and inefficient systems of book-keeping and accounts are still too common ; systems under which masses of more or less unimportant and unrelated figures are produced, and under which figures of vital importance lie dormant in the books because neither the bookkeeper nor his employer know how to make use of them. You will agree that there is no sense in recording business facts unless they are to be made use of.

I also deal with the attitude of the auditor towards inventories, and their verification with the cost accounts both as to quantity and value, and the relationship of income-tax to inventory values. These are important practical matters, but I have no time to enlarge on them now.

I also suggest that the auditor can and should help his clients, and safeguard himself, at the same time, by advising the use of a simplified form of cash book. I think you will agree that the use of the cash book for purposes other than pure cash transactions is a departure from the simple rules of good bookkeeping that is fraught with danger.

I further suggest that the auditor should, where necessary, advocate a more scientific treatment of the question of depreciation ; and I am glad to see that this important matter is excellently and adequately dealt with in another paper.

Under the heading of Service as Advisers, I point out how many business concerns can be and are saved from bankruptcy by the intervention of accountants who specialise in this kind of work, the necessity of a knowledge of economics and finance for those who help in this way, and the advisability of instituting courses of research in accounting and economics for the benefit of industry and commerce. I refer to certain kinds of research work being undertaken by universities and schools of economics. That is all to the good, but more is needed, and I submit that collaboration between economists and accountants in work of this nature, especially by trained accountants who have a good knowledge of economics, will be found of inestimable value to commerce and industry. The ramifications of present-day business are such that a knowledge of accounting alone, or of economics alone, is not sufficient. Matters relating to business policy and development demand a knowledge of both.

If I required any justification for stressing the importance of the subject

of my address, I do not have far to go to find it. Let me quote to you two or three sentences from the current issue of *The Accountant*, copies of which I observe have been graciously presented to each member of the Congress: "The depression has brought home to the executive of every business unit the imperative necessity of attending to the minutest detail of organisation, and that in its turn has stressed the importance of accounting as one of the chief tools of business administration." "The old-fashioned auditing was, generally speaking, a criticism after the event. . . . It is now seen that accounting must come closer to the day-to-day facts of business with a view to providing for the use of executives a current summary of events and a means of extracting essentials from a mass of details otherwise formless. . . . The present, and perhaps still more the coming, generation of accountants is interested in economic discussion, and though the field is admittedly very difficult is able to give it a practical turn by closely associating theory with reality."

In closing, I repeat my main contention that there is a serious and urgent call on the accountant to assist the management by planning, forecasting and periodically testing by results, in the difficult task of making profits, or at least avoiding losses in these difficult times; and the profession in this and other countries will be judged by the extent to which it responds to this call. (Applause.)

THE CHAIRMAN: I will now ask Mr. Robert Ashworth to introduce his paper on "Mechanical Accounting."

MR. ROBERT ASHWORTH, R.D., F.C.A., F.S.A.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, I understand that the paper I have prepared for this Conference on the subject of "Mechanical Accounting" has been circulated and is to be taken as read. Therefore, my chief task to-day is to introduce the paper to you as briefly as possible in the few minutes that have been allotted to me for that purpose.

You will observe that the subject given to me is the extremely wide one of "Mechanical Accounting," bringing under consideration the accounting and statistical requirements of management, accounting and statistical system, as well as accounting machinery. Consequently, I have found it very difficult to encompass the subject in the forty pages recommended to me as a maximum, and even then from only the British point of view.

Management in this country is beginning to realise, slowly, it is true, that the finest training for the high administrative positions in industry and commerce is that of the professional accountant. It is, therefore, of

extreme importance that the accountant should be in a position to visualise the business as a whole through his accounting and statistical information. To enable him to do this, while carefully avoiding over-elaboration, he must have available an accurate, up-to-date, and adequate analysis of accounting and statistical data. Without the aid of a proper system of mechanical accounting he cannot be placed in this favourable position without enormous expense if the business is of any magnitude. My paper endeavours to show, amongst other things, that in the system of mechanical accounting the accounting machines are only the means to an end and are not the all-important part of the system. Proper classification of accounts and interpretation of results is of even greater importance.

I shall content myself for the few moments left at my disposal by summarising as far as possible the principal points I have endeavoured to bring out in my paper, which are as follows :—

(1) We are living in a mechanical age, and the tendency of invention during the past thirty years has been definitely to increase speed, decrease distance, and greatly reduce physical effort.

(2) The volume of business transactions has grown enormously with the provision of increased transport facilities and the adoption of mass-production methods in manufacturing.

(3) Management is becoming more dependent upon the accountant, not only for information, but for guidance in tracking and rectifying wastages and leakages in all the ramifications of the business, including that of management itself. The accountant of to-day must, therefore, be prepared to take a leading part in the administration of the business as a whole.

(4) Mechanisation of the office has not kept pace with mechanisation in production, due mainly to the fact that the office in the past has been looked upon by many as a necessary evil, being considered merely a non-profit-earning department of the business. It is surprising how many concerns still exist which are satisfied to accept a much lower standard of efficiency in the office than they are prepared to countenance in other departments of the business. The successful businesses to-day are those which make the office the heart of the concern.

(5) The essentials to any successful mechanical accounting system are :

- (a) The accountant must have a high conception of his own duty to the business.
- (b) Accounting machinery must be the servant of the accounting and statistical system and not its master.
- (c) There must be adequate and automatic analysis.

- (d) There must be an avoidance of over-elaboration and the burdening of machinery with unnecessary work.
- (e) Work which has ceased to be of service must be eliminated promptly.
- (f) There must be a standard and consistent classification of accounts.
- (g) There must be co-operation with the auditor. In examining mechanical methods from an audit point of view, the auditor must be prepared to make necessary adjustments in his programme to meet business requirements, provided he can satisfy himself by adequate tests that—
 - (i) all transactions are properly recorded ;
 - (ii) all transactions are properly authorised ;
 - (iii) the usual accountancy safeguards have been preserved and the possibility of collusion reduced to its minimum.
- (h) The installation of accounting machinery must be carefully planned.
- (i) Machine operators must be properly trained.

With regard to the machines themselves, I have endeavoured to indicate the principal factors which, in my opinion, should govern the choice, but I have definitely refrained from recommending any particular make of machine, because this is entirely dependent upon the varying accounting and statistical needs of each different class of business. Also, machine development is constantly taking place ; for example, there is about to be placed upon the market a German machine which has all the features of a calculating machine, being able to add, subtract, multiply and divide, and at the same time print the multiplicand, multiplier and product, or dividend, divisor and quotient, which is, as far as I am aware, a great advance of any present accounting machine construction.

My paper does, however, show you the main considerations which should guide you in the choice of machines, but the most important guide is the demonstration of the machine itself, which, if practicable, should be obtained on the actual work for which the machine is being considered. This demonstration will be given freely by the manufacturers or their agents.

All accounting machines are equipped with features that practically produce the same accounting or statistical results, and the relative merits of the various classes of machines will depend upon the method employed to obtain those results and the class of work for which the machine is required.

In dealing with the punched card, or tabulating, system, I state that Powers' machines cannot be rented, but must be purchased outright or on hire-purchase. While Powers have, within my experience, in the past adopted a policy of discouraging the supply of their machines on a rental basis, which has led to a general impression that they cannot be rented, I am now informed that they are prepared to hire out their machines on this basis to those who do not wish to purchase, and, in fact, I find that they have so advertised recently with regard to their smaller excellent machine, the "Powers Four."

There can be no doubt that mechanical accounting has come to stay. If, therefore, my paper has been the means of stimulating greater thought on the subject in our profession, it will have served its purpose. It must be emphasised, however, that if full benefit is to be derived from mechanical accounting, we must realise not only the need for production of adequate data, but also the even greater necessity for the proper arrangement of that data and its intelligent interpretation.

MR. ROLAND DUNKERLEY, F.C.W.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, may I, first of all, congratulate Professor Annan upon such an interesting paper on so wide a topic. As he said in his opening remarks, this paper can be regarded from many standpoints, and I have taken my view from the standpoint of one within a business who has to deal with his question.

Professor Annan, in his review of "Accounting as an Aid to Commerce," has covered a wide field, and whilst he has dealt with the theme from an application standpoint, he has taken the opportunity of suggesting some thoughts to the young accountant on matters pertaining to his training. He has also made suggestions to those responsible for that training which, I have no doubt, will be given the attention they deserve. But that side of his paper I leave to him.

He has wisely interpreted "Commerce" to cover both large and small businesses. We do not always realise that the great majority of businesses in this country is small businesses. An important thing one is apt to overlook is that in every business, be it large or small, every function in management is carried out. In the small business one man may incorporate several functions, while in the large business specialists in each function may be found necessary. I mention these things because we, as accountants and specialists, may be inclined to regard our function as of paramount importance, whereas the manager or director to whom our

advice is offered may be deeply concerned in the works side, the purchasing side, or the selling side, and may regard us as a necessary evil. This being so, we must find out to what extent our advice, as it touches other functions, is being covered by other advisers. This will be necessary, particularly when we come to the interpretation of our information, because this, after all, should be the aim of our work. The building up of figures and information is only a means to this end. I wish more accountants would realise this, and appreciate the significance of the remark in Professor Annan's paper that "figures may be seen with the eye, but are meaningless unless they pass through the brain."

This demand for interpretation, if it is to be effectively answered, postulates speed. To-day, business moves so quickly that to-morrow's problems demand answers, whilst to-day's problems are being tackled, and with the growth of budgetary control accounting, and particularly cost accounting, is largely becoming a report on why anticipations are not being fulfilled. Cost accounting to-day is a running commentary on current events. Weekly, and even daily results are demanded, and Mr. Ashworth in his admirable paper on "Mechanical Accounting" has indicated how this modern demand is being met. In the companies with which I am connected daily statistics are available, trading results are prepared weekly, and consolidated every four weeks. These commence to reach the co-ordinating office from two to four days after the period end.

I am sorry that in dealing with periodical statistics, Professor Annan did not bring out the great advantages, from the point of view of comparison of the institution of the thirteen four-weekly periods as against the usual method involving calendar months having varying numbers of days.

To-day, with rapidly changing conditions, comparisons with past results are not enough, and I think the author of the paper has wisely brought out the necessity for setting up standards against which actualities can be measured. Standards must be set up in every sphere, not only of the performance of the workmen, but of the salesmen, of the purchases to be made, the investment in stocks, of financial transactions with particular reference to special projects, in addition to the general expenses incurred in running a business.

On page 261 Professor Annan suggests some type of statistics which might be submitted to managements. Again, I emphasise that it will be the interpretation of these statistics that will be required, not the sta-

tistics alone, and in using these, something against which to measure them will be necessary. If standards have not been set up and comparisons with the past are used instead, the accountant will find when discussing these that he will be met by explanations of the differing conditions under the two periods of comparison, and his investigations will be countered by a series of excuses. If standards have been established, then he can ascertain the reasons why these have not been attained, and the resulting discussion will provide the foundations for future action or change of policy.

If accounting is to be an aid to commerce, it must be right up to the place and time of action, both with its figures and with its interpretations, otherwise it will only add another layer to the dump of unappreciated effort.

Professor Annan has pointed out that men with accounting training are being asked by the business community to take part in the management of concerns to-day. In the past this has not been done largely until the decline has set in, and the trouble has reflected itself in the financial results. Why wait until then? Business men with accounting training are needed all the time to check "the insidious development of unsatisfactory features" which Professor Annan rightly ascribes as the cause of many failures. The campaign against waste and inefficiency must be waged every day, and modern systems of cost accounting provide for this. It will not be done by accounts produced weeks after the event, but by returns, by cost information, by statistics running concurrently with the event, and by the aid of forecast figures which will indicate the probable result of an action before that action is taken. Action taken as the result of considered information is a justifiable business risk, and most managements will be content to be judged on the result of it. Action taken on somebody's opinion is a gamble, and to-day business provides no margin for gambling.

As Professor Annan has taken the viewpoint of the accountant, I have tried to take the viewpoint of the "application" of accounting, and therefore I do not propose to comment on his suggestions on the valuation of work-in-progress and stocks, and on the suggestion he makes on depreciation, &c., with which, in the main, I agree. These seem to me to be detailed matters on which commerce looks for a direct pronouncement from the accountant, and are being discussed in other papers in this Congress.

Cost Accounts and Inventories which perhaps might be further emphasised. He points out on page 266 the variation in types of costs, and mentions the use of costs for price fixing, their use for valuation of work-in-progress and he might have added—their use for measuring efficiency.

On page 268 he issues a warning on the effect of extraordinary circumstances on costs and particularly their build up in times when production is subnormal. If costs are to be used for any of the purposes mentioned, the effect of subnormal working needs to be eradicated.

Incidentally the cost of this subnormal working, or shall I say *loss*, due to this subnormal working is a very instructive figure to management, as it represents the cost of standing idle and gives some indication to the answer to the question management asks, viz. at what price can we afford to take business to keep running.

In our own business our trading accounts are actually built up on three factors :

Trading Profit ;

Trading Loss ;

Loss due to subnormal working ;

and I assure you the latter figure gets all the attention it obviously calls for.

I would like to support the remarks in the paper on the subject of research into problems allied to those on which accountants are asked to make definite representations, and to support him in his plea for a greater study of Business Economics and Finance, not only by accountants but by business men generally. Could not a Congress of this magnitude recommend to our schools and colleges the inclusion of this subject in their curricula for the finishing stages of a boy's education, especially where the boy is proposing to take up a profession connected with business? There is no doubt but that much good would result therefrom.

Professor Annan finished up on a note with regard to our present economic structure which requires more than a passing thought, and so I leave it. Commerce may have learned lessons from its adversity ; I, for one, believe the purging effect will be lasting, but never again will it be content to know " after the event." Accounting will, therefore, need to adjust itself to the new conditions if it is to be an effective " aid to commerce."

MONS. J. POLAK (Holland) : Mr. Chairman, my Lord President, ladies and gentlemen, in the first place I will begin to do homage to Mr. Robert Ashworth for his very interesting paper he has prepared for this

Congress. My reason for coming here is not to criticise the work Mr. Ashworth has done, but merely to complete in some way the things he has said.

You must know that for more than ten years I have followed with great interest most things which have been published on this subject and I must say it is the first time I find a colleague who sees the things in about the same way as I did so from the very moment I took it up. It did me a lot of good when I read on the first page: "There must be no misunderstanding, however, about this title, for there can be nothing mechanical about the function of accountancy." That is without deduction from the contents of the other pages, for me the most essential of the whole booklet, and the very thing that must be told and retold to everyone interested in the problem of "mechanical accounting." There is no difference between the rules which an accountant has to plan when he has to do his work in whatever business it may be, whether the administration has been mechanised or not. We, working as auditors, take no fewer precautions where business machines are used than in a business where they are not, for the working with the machines gives no more guarantee than the working with pen and ink. Not in the larger concerns, but in the smaller offices, where machines have been introduced in the bookkeeping, there is always a danger that the internal check which existed formerly in the administration has been taken out in the following way. Items which were entered formerly two or three different times each time out of the original piece, and in such a way that two or three times the amounts were totalised, are often with machines made simultaneously with the original piece by writing same with two or three copies. When these copies are totalised each in a different way and at the end the totals are the same, there is no certainty that there is no mistake in the whole thing, for when in the original piece there was a mistake, that mistake will be in the whole. The same with a punch card of Hollerith or Powers. And therefore the certainty, which came formerly out of the accounts themselves, now must be taken by totalising beforehand from rough copies, which as a rule are totalised with an adding-machine. The sum total of these rough copies must be the same as the one of the bookkeeping but the safety has been removed out of the accounts themselves.

The great advantage the machines have brought is in my opinion the following :

They have opened our eyes to the fact that most offices are not organ-

ised in a way which is up to the standard of good organisation. Most bookkeeping has grown ; originally intended for smaller businesses, when businesses have grown their bookkeeping methods have not grown with them. They are as factories which have developed from a small output to great makers. As a rule you find everywhere in such factories departments or parts of departments which still retain the situation such as it was when the firm began, next door to departments where the most modern equipment has been installed. If you would found now-a-days a factory for the same output, it would be built and equipped in quite a different manner. In the offices formerly there was never a necessity to examine the way in which the output of the office (that is the accounts) were made. When there was more work people took more clerks. Nowadays where machines in different classes and prices are offered, the bookkeeping is handled more or less as a factory, that is to say, that in the same way as the manufacturer examines the way in which he must extend his output in the factory, he will examine the way in which the output of the office can be made. That leads to the examination of all the work that is done in the office and to a planning, just as in a factory, of the work that has been done hitherto and the work that *has yet to be done in future*. Without machines we should never have got so far and in my opinion that is the great advantage. It is my experience that alone by planning the office work, even without the use of machines in many cases, the advantage of mechanical bookkeeping can be derived but without the machines we had never come to do this planning work.

What I am saying here does not include the work in the large offices where hundreds of equal items are booked daily ; there you cannot work without the machines.

In a small office the work can also be planned so that it is done mechanically without machines.

There is still one thing to which I will draw your attention. On page 302 Mr. Ashworth says in the middle of the page : " This daily balance of ledgers is one of the greatest advantages of mechanical accounting and it extends, of course, to all ledgers, whether they be accounts payable, accounts receivable, or nominal."

I should say in large concerns there may be a necessity to know the daily balances of banks, accounts receivable and accounts payable, but for most of the accounts, with the exception of bank businesses, a daily balance is of no use. It has been introduced by the machine sellers and

accepted by officials as a splendid thing but as a rule nobody looks at it. Principally it must be done because the control over the ciphers made up mechanically is more difficult than when the accounts are made up in the old pen and ink way! Should you not make the control daily it would take much more time than formerly; so out of an inconvenience of the mechanical accounting a means of propaganda has been made and Mr. Ashworth, who controls the whole so ably, made, according to me, a slip of the pen when he wrote the above paragraph without drawing one's attention to the above.

There are still other little points to which I could refer but I have taken already too much of your time and I thank you for your attention.

MR. ALEXANDER S. BANKS, C.P.A. (United States of America): Mr. Chairman, my Lord President, ladies and gentlemen, I find that I am very restricted in the few comments that I can make. Coming over in the boat I had an opportunity to read Professor Annan's paper and in it I found a great warning to all practising accountants. This warning is hard for me to express and I should like to use an illustration, if I may, of what the warning means to me as a practising accountant.

Maine, in the northern part of U.S.A., is a great vacation State which is visited by a great many of our people. It is a densely wooded State and those people take their fishing rods and other things and venture further and further into the woods and, as inevitably happens, some of them get lost. This occurs every year. Those lost vacationists are all very human and they act in one of three ways. The first class realise, being lost in those woods, that their plight is desperate and they run around, mostly in circles, until they are exhausted. The second class lie down in despair and probably curse the ill fate that has overcome them. But there is a third class; and they are wiser; they climb up a tree and they look to the west and there they see the Katadan Range, or they look to the east and there they see the great St. John Range, and they vision how they can reach those points in safety. If they are wise they select a monarch of the woods, some enormous oak or ash or spruce, they mark it and walk towards it and, from marking those big monarchs, they eventually reach safety and the highways.

It seems to me that in Professor Annan's admirable paper he tells us to vision and work to find out straight lines and to do things before our energy is exhausted. I feel that that is what we have to do. Commerce is calling for us to help. We must listen to the call and must be careful to answer it and to give commerce the help that it requires, otherwise

it will avail itself of the service of others. I thank you very much for giving me the opportunity to address you.

MR. S. H. GILLET, F.C.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, I should like, first of all, to congratulate Mr. Ashworth on his very able and inspiring paper. Those of us who have the privilege of knowing him personally—and I number myself amongst them—know that the viewpoint that he has placed before us is the outcome of his own varied practical experience, and this fact must add materially to the value of his remarks. What the business man requires from the person who should be his best friend and adviser, namely, his accountant, is practical advice.

Speaking as one who has had practical experience in the reorganisation of businesses of varying types during the post-war period, including the mechanisation of their counting houses and the installation of more modern methods of preparing and submitting statistical information for the use of the executives of those businesses, I consider that this paper which we are now considering is to my mind one of the most important on the programme of the Congress. Having made that statement I now propose, in a very brief manner, to substantiate it.

The appeal that the paper makes to me as a practising accountant is that it stresses the need of scientific management and it urges the qualified accountant—as one who is trained by specialised education and practical experience—to develop his powers of analysis and organisation to the utmost—to play his part in fulfilling the demands for such management in the business world to-day. This means that the accountant must bring into play the knowledge that he possesses both from the accountancy point of view and the auditing point of view, and it is in this dual capacity that he should fit himself so that he may be able to guide both the executive for whom he may be working as financial controller or the directors with whom he may come into contact as the auditor of the company.

Mr. Ashworth rightly stresses the necessity of avoiding “statistical indigestion,” and it is here that the trained mind of the practical accountant is so essential. Only recently I came across in practice a large business with a most efficient system of accounting—with ample statistical information available—that, lacking a trained mind as controller of its finances, failed to perceive from the mass of data supplied to it that it had locked up its liquid capital, with the result that it had to seek a moratorium from its creditors.

The preparation of statistics must have only one object in view and that is to provide such up-to-date information as is absolutely necessary to enable the executive to manage the business in the most efficient manner, and mechanical accounting must be introduced with a view to assisting in that object. It is, therefore, clear that the accountant as financial controller should assist in the devising of the system that is most applicable to the individual business or group of businesses under review. His first task must be to ascertain the information and statistics required, after which he should be competent to choose the best way and the best machine to get this. It must be the aim of those who manufacture the various types of accounting machines to help the accountant and to make the machine fit the system; and not to expect that the system should be made to fit the machine. Most particularly, it must not be the aim of the machine manufacturers to sell to each customer the maximum number of machines that he can be persuaded to order, nor to make work for the machines; fortunately the accountant will find he can get considerable help from many of the machine manufacturers.

The "office" is still regarded by many businesses to-day either as an expensive luxury or an inevitable expense, but I say that this is due to the fact that accountants have been too modest in the past. What a business aims for is financial stability and profits. In order to achieve these the management is helped by up-to-date information and assistance which enables them to eliminate waste and unprofitable lines, and to control stocks and budgets. So often one finds in practice that financial data is presented to boards of management too late to be of practical use. In these days of rapid changes in values and policy the management of any concern that is successfully to survive demands quite rightly the most up-to-date data as to commitments, liquid position, &c. This is where the trained mind of the accountant, both commercial and professional, comes to the fore as he should be able to provide such up-to-date figures and the necessary guidance so as to be worthy of the name "controller."

A business has, in fact, three important divisions:—(a) Production, (b) Control, (c) Selling, and it is up to us to show by our constructive ability that we are capable of making use of the most up-to-date mechanical accounting so that the control may play its proper part in bringing about the financial success of any business in connection with which we are daily connected or frequently consulted.

We, in this country, have been very backward in the installation of

machines in comparison with countries like the United States and certain continental countries. This may be due to (a) Our conservative outlook, (b) Our mistaken idea of secrecy—contrast the information given by British public companies with American or Swedish companies, with their detailed quarterly reports, and (c) Difficulties of sterling, as until recently machine companies were not able to make machines which calculated in sterling as well as in decimals.

It is to be hoped that, as a result of the discussions at this Congress, accountants will in the future play a greater part in showing the business world and those who manufacture machines that they are completely *au fait* with the subject from every angle.

Most of us in this room would, I am sure, agree with the statement that there are as many, if not more, businesses in this and other countries being ruined to-day by bad management than from the result of bad trading conditions and there is a great field for the trained accountant if he understands the most up-to-date methods of accounting.

MR. T. ATKINSON GILLESPIE, F.L.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, the lecture we have had the privilege of hearing, by Professor Annan, on the subject of "Accounting as an aid to Commerce," has been so thoroughly comprehensive that all I propose to do is to stress and perhaps enlarge upon some aspects of the subject, already very ably dealt with by him. I do not think that in his opening remarks he has overstated the value and importance of the services of accountants to commerce, for it is assuredly true that those services are becoming more and more recognised in these difficult days, perhaps more so as a result of such difficult days.

The opportunity to render valuable and expert service to commerce, in its vital struggle, by a professional body of men, well qualified to do so, has been placed before us, and I think the profession, as such, has fully responded to the call. The accountancy profession has, if I may say so, passed on from being an "aid" to commerce to become a "vital factor" in the progress and success of commercial undertakings. Evidence of this is to be found in the fact that the services of qualified accountants have greatly increased in all the three branches of service referred to by Professor Annan at the beginning of his paper. (1) In important administrative posts in commercial undertakings. (2) As auditors or accountants, even where no legal obligation requires their services. (3) As advisers. Commerce and industry are ready to

welcome the further assistance of the accounting profession in new fields of co-operation. Let us indeed not wait for commerce to find out new ways in which we can support and assist it, but rather let us as pioneers ourselves, by a keen and foreseeing insight into their problems and difficulties, joined with our experience, point out to them new fields of co-operation. In this way alone will we fulfil our rightful mission ; not only to aid commerce, but to guide it, as far as in us lies, back to prosperity and a golden age.

Students must not only have the right education to become qualified accountants, but to appreciate the fact that they have to become good citizens. Accountants must not only be able to understand figures, they must be able to understand men, and particularly business men, and must acquire such a knowledge of their practices as will enable them to read between the lines of accounts submitted to them. It therefore goes without saying that the accountant must be a man of strict probity and great moral courage. He may need both, should he happen to be employed by some unscrupulous company promoters.

I have never forgotten what Colonel Montgomery said when he called to order the Congress in New York in 1929, at which I had the honour and privilege of attending. He said this, among other things, " We are here because, in accounting, we can point nowhere to anything final." Progress is essential ; it is not enough to say that accounting is a necessary adjunct to commerce and finance ; if it were merely an adjunct its usefulness would be limited. He went on to say, and this is most important, " Unbridled speculation in securities and unsound practices in business always result in demands upon accountants to overstate assets and profits and to understate liabilities and losses. When others do not keep their feet on the ground, we must do so." I thought at the time this was said that the Colonel's remarks were a true echo of the principle enunciated by the greatest Teacher that ever lived, viz. : "If thine eye be evil thy whole body shall be full of darkness. He conquers twice who, when a conqueror, conquers himself."

Articled clerks might very well be urged to realise the importance of not confining their efforts too particularly to merely passing their examinations, but seeking eagerly all practical avenues of knowledge at their disposal, viz. going behind purely audit matters, studying actual administrations of business records, and noting inadequacies of system. Articled clerks perhaps in general do not sufficiently avail themselves of these opportunities—" Off the beaten track " opportunities.

INCOME TAX

Another important feature in which accountants are able to render good service to commerce and industry is in the matter of income-tax, the complications of which do not seem to grow less. Unfortunately, it is no uncommon occurrence to sustain a loss in industry these days, and the question of relief which may be obtained against such loss is somewhat complicated. There is a great difference between evading tax and availing oneself of the relief to which one is entitled, if one only knew. The services of accountants in income-tax matters occupy considerable time and constitute, perhaps, one of the most expert branches of their service. Sometimes one encounters cases where income-tax matters are regarded as so expert that those accountants not engaged on it regard it as outside their province. It is never outside an accountant's province to be familiar with income-tax matters.

COSTING

Costing is one of the most promising fields for help and co-operation by accountants with industry, too long neglected and probably a very necessary adjunct to-day with the hope of reviving industry now confronted by such keen competition. Theoretical side of costing—probably one of the reasons why, as yet, not more widely adopted—must be brought into line with practical requirements. The matter of its adaptability to individual concerns must be more developed. Here, again, it should be more generally studied and advocated by accountants, and brought from a somewhat theoretical subject into the realms of practical utility. We might ask ourselves the question, how many of our manufacturers are without any efficient costing system in operation? How necessary, then, it is for the accountant to be tactful in his dealings with men of business, many of whom know more about costing, in their own particular business, than the accountant, but lack method, and not knowing how to turn it to account. It is just here, in our knowing men as well as figures, that we can prove of great service and gradually lead those men into the way they should go, but, before doing so, we must first ascertain the particular nature of the business, as to the goods manufactured, its process of manufacturing, and so forth, but above all do not boast about what you may consider to be the best and do not in any way pour cold water on the methods your client may have had, bad as you may think they are, as this is a sure way of turning him against you.

IMPORTANT SIDE OF COSTING

The writer, Professor Annan, has dealt with a very important side of Costing, in the charging of interest on capital, and conflicting views are held about this, and personally I am inclined to believe that, theoretically, interest should not be charged in arriving at costs, on the ground that all interest is a form of profit and that no profit should be taken credit for until it has actually been earned, but as there are so many varied classes of manufacture, it is difficult to lay down a hard and fast rule and, consequently, it has to be determined accordingly.

No undertaking is started without some expenditure of capital, and the return on it—the income arising from the use of it—is, after certain deductions, profit. In some cases, all the capital sunk is represented by floating assets and those directly concerned with manufacture, but in other concerns it is represented by land and the buildings thereon.

In each case the profit that is earned results from the use of all the assets, and surely cannot be specifically allocated to any particular part of them. All assets are equally comprised in the capital of the business and the total net income from their use is the profit of the business and the total net income from their use is the profit of the business. Now, in some concerns the money for the purchase of some of the assets is raised by means of debentures, instead of by means of shares, and interest has to be paid on them. Surely this cannot affect the profit made by the business. Is the cost of production greater because the capital was raised in a different way, or does the question answer itself? Debenture interest is equivalent in nature to that rent, sometimes incorrectly charged in the books, for the use of lands owned by the undertaking, but it is an entirely different thing to the rent that is paid to an outsider for the use of his land. That is a standing charge against the profits of the undertaking—the former is not, and only confuses the costings when it is inserted. Thus we are brought back to the main question—should interest be charged at all? It is generally said that, theoretically, it should not, on the grounds I have already mentioned, that all interest is a form of profit, and it is a well-known axiom of accountancy that no profit may be taken credit for until it has actually been earned.

In any case, if interest is charged, I cannot see that debenture interest requires separate consideration, although it means that the costs of a concern not having borrowed capital would be less than the one which has, and must, therefore, be apparent to anyone that the result would be detrimental to the latter. However, Professor Annan has very clearly

drawn the distinction between arriving at the cost of stock for stock purposes and that for selling purposes, and we can rest assured the point is not lost sight of by the ever vigilant and inquisitorial Inland Revenue.

How essential then for the present-day accountant, and especially the younger members of the profession, who have their future to consider, to keep themselves to the forefront and, as Professor Annan states, the science of accountancy is now so wide and deep that it demands the undivided attention of men with trained minds and devoted with earnest zeal to the raising of the profession to which we belong to still higher degrees of usefulness.

Costing will probably find its greater adoption when more associated with the wider and more comprehensive aspects of it in business budgets and financial control. Certainly costing and control will feature largely in any industrial and commercial revival, and it is well for accountancy bodies to be well prepared in the matter.

THE CHAIRMAN: It has been decided to adjourn this meeting at 1 o'clock and to resume after lunch at half past two, postponing the other session from half-past two to three o'clock.

MR. S. H. GILLET, F.C.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, may I say in the first place that I am sure that we all agree that the title of Professor Annan's address is not an easy subject with which to deal, for, as he so aptly remarks in his opening, it is very difficult to imagine commerce successfully continuing in these days without the aid of the accountant.

The most important point that to my mind requires to be stressed is that to-day accountants' work is more generally advisory *before* the event, and the purely auditing and arithmetical work is performed *after* the event, and is possibly the easier of the two functions. The first function is certainly the more valuable to commerce.

I do not think that Professor Annan has drawn sufficient distinction between auditing proper under the Companies Acts and general accountancy work, and by including income-tax with auditing he does not bring out the importance of the professional accountant's work in connection with the income-tax paid by commerce. For example, there must be an undoubted significance in the appointment of Mr. Hill to the Committee on Taxation of Co-operative Societies.

Reference must also be made to: A.—the rapidly increasing scope for skilled accountants as business advisers in the present economic sphere. This is due to the following factors: (a) The tendency, now well advanced,

for an increase in the size of the business and commercial unit, and the greater the size of the unit the more important becomes the position occupied by finance and the more difficult it is to find persons capable of controlling such finance. It is here that the expert accountant can be of inestimable value. Incidentally, it is probable that the chief retarding factor in the growth of the present large-scale organisations is the difficulty in finding men capable of controlling such organisation.

(b) The present economic conditions, which have placed almost every class of business with their backs to the wall. As an outcome we have firstly rationalisation, if matters are taken in hand in time, and secondly reconstruction, if matters are left too long. In both cases finance is the backbone of any scheme and reference to actual cases will show how soon expert accountants are called in to assist. (c) The tendency for public utility services to become public trusts, under the greater or lesser control of the existing Government; recent cases, for example, the London Passenger Transport Act, show how important is the accountant's part in the carrying out of any such scheme. B.—the necessity for to-day's practising accountant being well versed in general business knowledge. In these days the knowledge of economics is most invaluable, and if such matters as business forecasting can be studied the accountant will be even more valuable to his client. It is not unreasonable to suppose that in the not too distant future professional examinations of the various bodies will be widened and that students will have to include this subject in their professional training.

Finally, the accountant's work should be objective. That is to say, the initiative should come from him, and the accountant who is merely passive is not, I consider, making himself of the fullest use to commerce. This applies to all kinds of accountancy, from reorganisation to taxation. The accountant as distinct from the auditor must be prepared to study the particular class of business of each client; for example, if he is discussing the accounts of a drapery business he should know what are the percentages for each department, apart from the percentages that the business should earn as a whole, and how many times a proprietor should turn his stock, and the reasonable percentages that the various headings of expense should bear to the turnover. He should criticise the balance sheet each year when going through the accounts with his client from the point of view of its liquid position. In short, he should be able to discuss the business with his client as if he were his partner or co-director. He should be first in the field in any scheme of re-

organisation of capital. He should draw attention to the locking up of liquid capital and he should be able to present a scheme for legitimate avoidance of death duties or heavy taxation. The client should be trained to turn to his accountant for advice as second nature, and I have found in practice that the more useful one makes himself to his client the more he appreciates and values it, and, incidentally, one adds to one's own general knowledge. We are much too inclined to say that "such and such a matter" does not come in our province as auditors. There is probably much that does not come into our province as auditors, but there is a great deal that does as accountants. The more we can train the business world to look to us as givers of sound practical advice the more we shall widen the scope of our useful activities. We must not be afraid to express our opinions in writing, but they must be definite, for a warning to a business man at the beginning of his financial year is, I am sure, more helpful to him and more appropriate than a few words of sympathy on accepting the appointment as liquidator in the winding-up at the end of his financial year.

MONS. J. POLAK (Holland): Mr. Chairman, ladies and gentlemen, I was asked by the secretary of the Congress upon which subject I wanted to enter into discussion. This may be considered as the best proof that, when choosing the present paper, it was not in consequence of my disagreement with the conclusions of Professor Annan. On the contrary, I wish to confirm a great part of what Professor Annan has written and which he has explained more eloquently than I could possibly do.

If yet I am to make a remark, I want to state that the title of the paper does not fully cover the contents. The paper is headed "Accounting as an aid to Commerce." It deals rather with accountants as an aid to commerce. I should have preferred to speak about accounting.

If we, as accountants, should aid commerce, it will not in the least be by advocating the slogan "Accounting as an aid to commerce." This slogan sounds very attractive. Is it not, though, remarkable that this should be a point of discussion at a Congress on accounting, after so many ages of accounting, so many centuries after the invention of bookkeeping by double entry? Is it not a *testimonium paupertatis* for whole generations of accountants and bookkeepers?

And, still, if we are open to see things as they are, we must confess that it is necessary. Too many business men see accounting only as a formality prescribed by law or by the articles of association, asked for by the income-

tax authorities but always as a nuisance, at best as a necessary evil. But before we blame our clients for this conception, we must first ask, are not many accountants in default? Do not many accountants speak a language which is not understood by business men; do not too many of them consider bookkeeping as a final aim?

Here I want to refer to Mr. Ashworth's paper where it is said "Management must have its information accurate, up-to-date, legible and in the most easily digested form." I should like to go further. Within certain limits, of course, I should dare to waive a little accuracy if thereby the accounts could be more up-to-date.

In Holland we more and more come to the conclusion that our clients do appreciate the information we submit to them provided (a) we give it in a concise form, (b) we give it up to date. But they do not care for being wearied with too many figures, and I fear this might be the case if we gave them records of all data referred to on pages 261 and 262 of Professor Annan's paper. Of course, everything mentioned here is interesting. The accountants must be able to procure these figures, but must they all be periodically submitted to the manager? If we want to enable the management to know all that will be of use for the direction of the business, we should not give any figures which are normal but we should only submit any deviation from the normal. We must start by establishing what is normal; normal cost prices; normal capacity; normal expenses; normal turnover, normal credit terms, and so on. I shall not deal with the question how these normals are determined; by budget, by averages or on any other methods. But once the normals are established, the task of the accountant is to mark every deviation.

The manager does not want a full list of debtors who have paid in time, of sales at price list prices, of production in accordance with the capacity, but of the debtors who are in arrear, of sales at reduced prices, of the departments which have had a too low production. If we succeed in developing accounting in this direction, it will certainly be a very valuable aid to commerce.

THE CHAIRMAN: Ladies and Gentlemen, we now adjourn for lunch and we resume at half past two.

(Adjourned until 2.30 p.m.)

On resuming:

THE CHAIRMAN: The first speaker at our resumed meeting is Mons. Kamil Augsten from Czechoslovakia.

MONS. KAMIL AUGSTEN (Czechoslovakia): Mr. Chairman, my Lord President, ladies and gentlemen, if I may be permitted to refer to the remarkably instructive and lucid lecture of Mr. Robert Ashworth, and to discuss the conditions indicated in the title prevailing in my young national state, the Czechoslovak Republic, I must first of all set out the following points.

Though in none of our most important commercial banks can accountancy be discussed to the full extent in terms of English or American organisations, there yet exist control departments, defined by law, appropriate to their purpose, which operate intensively. In particular, checking of the position of debtors has been developed to such an extent that to-day it corresponds to a model of scrutiny, namely, accountancy.

A modern and comprehensive mechanisation in all directions is not yet in operation in each of our banks, and even where it exists, entirely different methods of operation are in use. Indeed, our most important establishment, the Zivnostenska banka, which in a few years has attained through efficiency in management a prominent position as a representative of the banking world of our continent, has even to-day not been able to abandon the old and well-tried security of bound books, and considers its correspondence with customers in eleven European languages as a further hindrance to mechanisation. Over and above all, in this bank the order and reliability of its whole apparatus, well recognised for many years, has not conduced to a desire for change in organisation.

But also the other important banks of our state can, with regard to their bookkeeping and control departments, hold their own equally well in comparison with foreign banking institutions. After collection of detailed information and personal observation of all the outstanding institutions of our capital city I can assert that everywhere, on the basis of an unconditional *à-jour* keeping of accounts, a daily trial balance is ascertained and certified at latest on the following morning, and that customers' accounts and the journal have already been collated by the beginning of the next business day. Thus the most essential and important object of a competent organisation is unquestionably attained in all of our banking enterprises.

With all readiness at any time to communicate detailed information about the internal organisation in our ten leading commercial banks, I will here merely briefly and concisely furnish some data which I trust may be of interest to my esteemed audience.

The principal motives for mechanisation in our country were as elsewhere—

Revival of business after the Great War, inflation (in neighbouring States).

Intended reduction in business expenses.

More rapid despatch of counting-house business and controls, above all balancing of current accounts and the daily trial balance, and therewith automatically compulsory readiness for the day.

Extension and improvement of controls and in this way of all banking operations (Accountancy).

The principles of organisation are varied :

Uniform Centralisation, e.g. the Bank of the Czechoslovak Legions, also the private banking establishment of Messrs. Petschek & Co., which was the first banking institution in our country to open its doors to mechanisation.

Uniform Decentralisation, e.g. the Bohemian Discount Bank and Society of Credit.

Combined Systems, especially well worked out and adapted to the practical requirements of individual lines of business in the Bohemian Union Bank.

Almost all types of machines known on the market are employed. For bookkeeping chiefly the Elliot-Fisher and Burroughs inventions are being used. Punched cards, namely Powers' device of the most modern type, are in vogue at the Anglo-Czechoslovak and Prague Credit Banks.

Everywhere there have been realised daily control of effective stocks of all kinds, and forthcoming evidence at any moment of the status of customers.

A survey of conditions in the Czechoslovak banks will yield the following data.

The call for mechanisation came to us after the Great War mainly from our neighbour Germany. In that country, this was partly accounted for by cheapened payments in inflation-marks. In our state the hoped-for results from mechanisation of bookkeeping and controls have been however attained only partly, as regards retrenchment in business costs scarcely at all. This may be explained partly by the fact that in Czechoslovakia the exchange of relatively higher qualified officials against cheaper workers could not keep pace with the tempo of mechanisation, mainly from social motives. Besides, the widespread decline in business of all kinds, especially in our industrial districts and above all

in branch establishments, hindered full utilisation of the capacity of machines.

But concurrently with the introduction of mechanisation, the directions of banks as a whole have undertaken drastic revision in respect of the proper conduct of work and controls. From that moment capable and interested leaders in organisation have been constantly occupied with this question, and, in my opinion, this is the explanation of the fact that all the banks interested have derived advantage from mechanisation.

British accountants who have already worked on the continent will bear me out that the business carried out in our banks is more complicated than it is in England and America. Customers are less educated, their requirements vary, the cheque system as contrasted with western conditions is still entirely undeveloped, while bank charges and commissions are so small that a large part of the turnover of the commercial banks yields no profit.

We must therefore all the more aim at a rational employment of mechanisation, and avoid increase of business costs, and I believe that the following experiences will prove of interest especially in countries similarly situated.

Large central banking establishments may employ those of minor education for mechanical work, but properly qualified officials for supervision and control. In smaller institutions an all-round education of individuals is indispensable.

In my country, as a general rule men have proved more competent in handling accounting machines than women. Inconvenient periods of daily working time are compensated by bonuses.

Connected work is carried out in adjoining rooms where possible. Difficulties arising from remoteness are surmounted through pneumatic and strap posting as well as by errand boys. Intellectual work is kept widely separate from machine rooms.

Printed sets of slips gummed at the side, as against perforated slips, permit the use of differently coloured paper.

Multiplicity of slightly differing forms is to be restricted.

Employees engaged with machines are also conversant with current repairs. In large establishments a regular mechanic is one of the staff occasionally with his own workshop.

Individual choice of machines is more important than price. As far as adequate utilisation is concerned, the dearer device is usually the

better. The increased costs of supplementary mechanism for the purpose of cross addition and automatic balancing are more than recouped since they save time, labour, and trouble.

At least as important as the system selected is appropriate accommodation to the practical needs of individual departments in detail and to joint work.

But even the best system of mechanisation is valueless without experienced and vigilant managers, and trustworthy and contented collaborators who take pleasure in their work.

In conclusion I take leave to submit to this great international assembly a few further proposals of wider importance.

Use of printed forms of letters by bank customers, as well as by State banks, clearing houses, post office savings banks, public offices, &c., which forms may serve as a basis for booking.

What great advantages a unification of organisation in the banks of the same country—at least in the main principles—would bring, is shown by the possibility offered that a bank giving an order to another bank could simultaneously execute the order form, the note for customers on each side, as well as copies for internal use—all this without multiplication of work.

Thus, in mutual interests secrecy will be avoided in favour of widest dissemination of practical working lines for mechanical organisation of bookkeeping and controls as well as for valuable mechanical aids to accountancy, paying heed to different conditions prevailing in different countries. Intensive propagation of suggestions for improvement by means of books, professional journals, the press, lectures, broadcasting, and training schools.

Above all, my esteemed colleagues, let all of us be prepared, in a spirit of gallant adventure, to face boldly and strenuously any emergencies which may arise ; let us each one prove pioneers of progress, practical and therefore welcome helpers in the difficult conditions of crisis through which all countries are passing.

I am sure all my colleagues from the Continent will agree with me, if I here declare in the name of them all, with a bow to the memory of one of the noblest and bravest naval commanders on earth, that we shall always remember his signal at Trafalgar—

England expects that every man will do his duty.

MR. J. SCOTT-MOORE, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, in the first place, I should like

to offer Mr. Ashworth my very hearty congratulations on what everyone will agree is a most painstaking and informative paper. Mr. Ashworth has dealt with the subject from the respective points of view of both the accountant and the auditor. My acquaintance with the subject has been a practical one, and mainly from the point of view of the accountant engaged in the endeavour to devise and apply the most economical means of accounting in the fullest possible detail for the expenditure of public funds amounting to some millions a year, in the provision, development, running and maintenance of a large number of public institutions. It is, therefore, from this point of view only that I can offer a few very brief remarks.

The functions of the accountant *qua* accountant may be broadly divided into (a) physical and (b) psychical. The physical functions I take to cover the operations of collection and arrangement of data, and the psychical those of interpretation of those data by intellect and reason. It is obvious that mechanical methods can be applied only to the former category.

In considering the physical compilation and arrangement of accounts by mechanical means, the first factor in the problem is the ascertainment of the extent to which the work consists of exactly similar operations upon elements differing merely in their dimensions. So far as work of this nature is found to exist, it is eminently suitable for mass treatment by machine, providing that the output is sufficient in bulk to justify the expenditure. It is questionable whether it is ever economical to employ machines, however great the bulk of total work, unless the work can be segregated into separate groups of nearly repetitive operations.

One factor of the problem is found in the necessity for securing that the system of accounting to which machines are to be applied shall be sound, complete, entirely devoid of non-essentials and not liable to variations of process. This aspect is of extreme importance for the reason that every machine has very rigid limitations, and any alterations to a system might involve extensive alterations to or even a complete change of machines. In this fact lies a distinct tendency for machines to assume the mastery.

Mr. Ashworth has dealt with this danger on page 288 of his paper. He points out that the machine should be applied to the system and not the reverse. This I submit is, in practice, only capable of application to a certain degree, and so far as the mechanisation of accounting work is possible both now and in the future, it must always

inevitably be limited by the capacity of available machines for the work required.

Where, therefore, the management of an undertaking desires to install mechanical means of accountancy, to my mind far the best course is to submit to selected makers of machines a scheme embodying the accounting system required, and to leave the mechanical experts on their side to devise and submit proposals for carrying them out by the available normal types of machines, or by machines specially modified or even designed for the particular purposes. It will almost inevitably be found that both system and machines will require modification before a satisfactory solution is arrived at.

Mr. Ashworth is undoubtedly correct in his contention that the ease with which analytical work can be accomplished by machinery has a strong tendency to encourage over-elaboration and unnecessary work. There is, however, another aspect to this. When converting a man-power system to machine-power, it is inevitable that certain minor processes readily performed by human beings will have to be scrapped, because they are incapable of performance by machine. When this stage has been reached, it is useful to pause and consider whether this scrapping of redundant work could not equally well be carried out and the desired economy effected by coupling with it the continuation of the man-power system. Put in another way, while bulk analytical work is easy by mechanical methods, and in consequence over-elaboration is encouraged, the adaptability of the human machine tends also to encourage the growth of other sorts of "frills" on a system which could, by constant review and strict though intelligent criticism, be dispensed with.

In outlining the demands of the management upon the accountant, the author of the paper has hinted at a measure of leadership by the office, but he has hardly laid sufficient stress on the possibilities of a progressive accountant equipped with up-to-date machines, as a factor in the functions of a complicated organisation. Increasingly the need for, and the aid of, some powers of prediction are felt in modern undertakings. The management not only requires to know, promptly, whether there have been increases or decreases, rises or falls, what is the magnitude of those changes and how they arise, but is coming to require information as to *rates* of increase or decrease and the influence or extraneous factors on such rates. The proper analysis and interpretation of such figures can only be provided by the accountant. They obviously become of more importance the more promptly and frequently they are provided. The

unmathematical executive is prone to attach importance to magnitude rather than to rate of change, and an accounting branch equipped with modern machines can best produce and present such information in the most convincing form.

One point to be borne in mind in comparing mechanical accounting means with more old-fashioned methods is that while the elimination to a large degree of the human element provides some decrease in the possibility for manipulation of entries and resultant defalcations, on the other hand the use of machines necessitates the increased adoption of cards or loose leaf records, and there are certain disadvantages in this which are well known to all of us. Mr. Ashworth dismisses these as fast disappearing prejudices (p. 309) but experience shows that there is a good deal of sound foundation for the prejudices.

The suggestion that the subject of mechanical accounting should take a prominent place in the professional examination syllabus, and that lectures and machine demonstrations should be provided by the various students' societies, is most valuable and it cannot be too strongly urged that it should be implemented by those responsible without delay. The makers of accounting machines are always ready to give demonstrations as a part of their advertisement campaigns, and much expense can be saved by taking advantage of this ready help.

On page 311 of his paper Mr. Ashworth claims that "the use of machinery in accounting requires a higher standard of intelligence and alertness in the machine operators than is usually required in clerks engaged in the ordinary routine of book-keeping." I have very grave doubts, based upon some years of practical experience, as to the truth of this contention. While careful instruction is undoubtedly essential before an operator can be trusted to manipulate a machine, the normal operating is automatic to such an extent that certainly no greater intelligence or alertness is called for than are usually found in the average clerk. It is a fact that the monotony of the work after a time places a severe strain upon the nervous system, and it is common experience that women operators suffer less from neurotic effects than do men. This strain, however, can hardly be described as "mental."

Dr. L. J. Comrie, Superintendent of H.M. Nautical Almanac Office, recently stated that the faster the process of transcribing a number the more accurate it is. He bases this conclusion on the observation that when figures are copied by hand, the mind has time to transpose or confuse them between the time they are read and the time they are written

down. With full keyboard machines the sight of a figure produces a reflex action so that the impression of the figure is immediately translated into the action of depressing the right key, and the impression then instantly fades, leaving the mind free to receive the next impression. Hence an operator who can attain high speed will also attain high accuracy.

In an opinion recently given by Lieut.-Col. Sir Arnold Wilson, Chairman of the Industrial Health Research Board, it was pointed out that the operators of calculating machines are seldom offered promotion to higher posts or pay beyond a certain point, and that in consequence the use of machines will not require a high standard of education. Sir Arnold claims that in time this will probably make for contentment. While this effect of the use of machines is to be deplored, I am confident that it is none the less the inevitable effect.

It will come to be recognised in time that a high standard of manual dexterity is far more important than a high standard of intelligence and education.

MR. A. CATHLES, O.B.E., C.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, I have no apology to offer for taking part in this discussion, as I am one of the many thousands who in Scotland, during the past two centuries, had fathers who, in the words quoted by Professor Annan were, or who were eligible to be considered, "decayed" merchants and I thereby became one of the beneficiaries of the goodwill of George Watson, the first professional accountant in Scotland and began my education in the art of bookkeeping in the school which he founded.

It will, in my opinion, show in my friends in Edinburgh a lack of appreciation of the fitness of things if in the course of the programme which they have devised for this Congress in Edinburgh next week, they have not included a visit to that School which is a not ill-fitting monument to Accounting as an aid to the accountant 200 years ago.

And if that visit is paid, the visitors may perhaps be pardoned if, when looking at what is admittedly a magnificent institution, they wonder if the merchants became decayed as the accountant flourished.

As I read it, Professor Annan's paper is a plea to the practising accountant to help commerce to make profits. That is a plea which I most heartily support, because I believe our profession can help if it will.

Our profession has grown in importance at least in this country, not because it has helped the business man to make profits, but because it

has been forced upon the business community by the requirements of the Government, the Stock Exchange and the banks.

The Government says "Thou shalt have an auditor," so the business man somewhat reluctantly agrees. It says "Thou shalt pay income-tax according to these most complicated regulations" and the business man sends for the man who has audited his books to help him out of his trouble. The Government and the Stock Exchange Committee say "Thou shalt have a certificate of profits in thy prospectus," and he sends for his own or someone else's auditor. The bank manager says "Before lending you money I want to see audited accounts" and again the auditor is called in. Later, when the bank cannot get its money back a practising accountant is given the job of selling up the business so as to recover as much as possible for the bank.

In all these functions the accountant undoubtedly renders valuable service, but in none of them is he actually helping the business man to make profits.

Surely, then, it is small wonder that on the whole the practising accountant is looked upon by the business man in commerce as a necessary evil.

Professor Annan has indicated that the first step we should urge our clients to take is to institute the preparation of monthly profit and loss accounts. I entirely agree, but these accounts must be efficient accounts, not merely tabulated statements of income and expenditure under the old-fashioned headings and in the old-fashioned form.

They must comprise manufacturing accounts which do show true cost of the products manufactured during the month, and trading accounts which show the cost and sales values of the goods sold and the expense of selling and distributing, and the expenses in these accounts must be shown under appropriate headings so that the efficiency of the expenditure on each of the activities of the business may be readily judged, because the business man's interest is in the efficiency of the expenditure and not in its volume.

From such monthly accounts it is only a short step to monthly departmental accounts, and (cost accounts (which after all are only an analysis of departmental accounts) are then just next door. And from sound cost accounts the business man can judge the efficiency of his business.

As a profession we have in the past paid a great deal of attention to the volume of expenditure and its authorisation and none to its efficiency. If we are to render really constructive aid to commerce we must devote

a great deal of attention to this institution of accounts which will show the business man the degree of efficiency which he is obtaining from his expenditures and thus we shall help him to make profits.

We shall then no longer be looked upon as necessary evils.

MR. RICHARD WITTY, F.S.A.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, most of you are aware that, I think in the year 1935, there is to be an International Congress of Scientific Management. Mr. Ashworth's paper that has been given to-day will be of very great interest then, as showing the progress which may be made between the years 1933 and 1935, because in his paper he has given us a very clear map of the advance trenches on the battlefield of commerce. I am therefore going to content myself this afternoon by just congratulating Mr. Ashworth on his paper, and if I may, I would like to hail him as a pioneer, a very worthy pioneer, in the important task of breaking through the ignorance, possibly it may be the lethargy, or possibly yet again only the conservatism of a large section of the accountancy profession towards this most important aspect of commercial progress.

MR. F. O. TILEY, F.L.A.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, I have read with great interest Professor Annan's paper on "Accounting as an Aid to Commerce" and have learnt for the first time that it is generally known as a Heaven-sent profession. Commerce cannot be carried on without the aid of capital, and therefore anything that accountancy can do to increase the confidence of shareholders in their investments must be an aid to commerce. At the present time the ordinary shareholder loses all control of his capital once it has been invested, and the report which he receives with the annual accounts once a year is extremely brief. I believe it would be an aid to commerce if we could assist the investor by amplifying the auditor's report. If instead of the bare statement we made comments upon the progress of a concern, showing the ratio between expenditure and sales, the investor would have some knowledge of how the business was really progressing. To-day beyond the bare accounts, which many shareholders do not understand, he only gets a record of the progress from the chairman's speech, and that necessarily is given with an eye to what is advisable to tell the public and the shareholders. I therefore venture to suggest that that is one way in which we could aid commerce. A previous speaker mentioned that the greater portion of our business lay in the direction of moderate and smallish businesses, and the heads of those firms oftentimes after you have gone to great trouble to prepare statistics fail to

understand what they teach. If much more use could be made of charts than is made at the present day we could interpret to intelligent people the meaning of these statistical figures. I make that as my second suggestion. Mr. Chairman, my Lord President, ladies and gentlemen, I thank you.

MR. JOHN MYERS, F.C.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, the Chairman wields the thunderbolts of Jove in such an inscrutable manner that I am afraid my remarks must be very attenuated, even at the risk of not being able to pursue my subject. (Laughter.) I am sure you will agree that we have listened to a most interesting and instructive paper from Professor Annan, and one which, when published, will be a valuable addition to accountancy literature.

Accountancy as a profession has many advantages, and so far as my experience goes, very few disadvantages. Amongst the advantages which may be placed in the forefront is the fact that a knowledge of accountancy, where the articled clerk or the apprentice has acquired it in an office which can afford all-round experience in general practice, carries with it a training which should prove invaluable in any future career after the term of service under articles. Not only does it necessarily fit the articled clerk for the practice of his profession, but it opens up the long and broad avenues of a commercial career.

That accountancy has always been an aid to commerce cannot be gainsaid. From very early days, methods of accounting, crude and simple though they may seem to us now, have accompanied and assisted the carrying on of trade. It is, however, only within comparatively recent years that accountancy as an aid to commerce has developed to the extent which it has reached to-day. At the same time I doubt whether accountancy has been harnessed and developed as an aid to commerce to anything like the full extent of the capacity of such development.

The first essential in the training of an articled clerk is a sound theoretical and practical knowledge of bookkeeping, and the articled clerk or apprentice is fortunate who has opportunities given to him in the early stages of his career in the office in which he serves his articles for writing up complete sets of commercial books and original documents. It is by this method that he acquires the ability to build up the accountancy systems of the businesses with which he may be concerned in after days, and it is this opportunity which will form the foundation of his training as a business doctor. Accountants are rapidly beginning to be regarded

nowadays, more than has formerly been the case, as business doctors, to be called in by all and sundry to advise the proprietors or, in the case of a limited liability company, the board of directors, (1) as to the state of health of a business which is failing or which at least is not giving satisfaction, or making the progress which might be reasonably expected of it and (2) as to the remedies for such a state of affairs which may be required to restore the patient to health.

I submit, however, that the duties of the business doctor are entirely distinct from those of the auditor, of which the lecturer has spoken. The duties of the business consultant are not necessarily of the same nature or confined to the same hard and fast lines as those of the auditor. The duties of the business consultant, when carrying out his cure, are practically unlimited, while those of the auditor, while not perhaps limited to his bare responsibilities, are to a great extent limited to the precise object for which he was appointed, namely, to guard the interests of the proprietors or shareholders by auditing the accounts of a company or business at a past date and certifying their accuracy. If I may say so with respect, there appears to be in the paper to which we have just listened a little confusion as to the work to be carried out by the accountant as an auditor and that which he may carry out as a business doctor or consultant. Professor Annan takes, and rightly so, a broad view of the duties of the auditor, but he seems to me to imply that the auditor should, in addition to the duties of the audit, always be on the lookout for improvements in the accountancy system of the company or business with which he is concerned, even to the extent of carrying out a considerable amount of work in doing so, for the purpose of making suggestions as to improvements to the proprietors or directors, who perhaps might very reasonably object to his carrying out, quite apart from his duties as an auditor, a great deal of work which, in their opinion, was unnecessary or not within his province and which in any case he had not been specifically instructed to do. It might well be that where an auditor had perhaps exceeded his duty in this way, he might lay himself open to adverse criticism from a board of directors either for such excess of duty or for the expense which it might involve.

Undoubtedly, in carrying out our duties as auditors we acquire most valuable experience, which fits us to act as business consultants. It sharpens our perception in diagnosing where weaknesses may exist in businesses, and it trains our faculty in estimating character and dealing with the faults and ailings of an element, which we have to deal with in

everyday practice, that is, the human element. I submit, however, to this meeting that while carrying out our duties as auditors, we should be careful not to exceed these duties, although we should, in order to prove our utility alike to the shareholders and to the directors, keep a vigilant eye for any channels which might be pursued and suggestions made to the proprietors of the business or the board of the company, in order that such might be followed by us in our other capacity as business consultants or doctors, if you like to use the term.

I was very interested, as I have no doubt we all were, on hearing the lecturer's views as to cost accounts and inventories. The examination of cost records, with a view to arriving at the value of work in progress in connection with an audit, is essential, but it is an examination which can, in my opinion, be carried to greater lengths than are necessary. Where an efficient system of cost records is kept by a factory, in my opinion it would be sufficient for the auditor, in endeavouring to ascertain whether the correct value of work in progress had been taken credit for in the accounts under review, to apply such a test or tests of the cost system and records as would satisfy him that the work in progress was correctly and honestly taken credit for in the accounts of the company. I submit that, if the auditor carried this out and was honestly satisfied with the result, he would be absolved in any question which might arise as to his competence or otherwise in carrying out his duties in this respect. He certainly should not accept without inquiry and test the directors' certificate as to the value of the stock and work in progress, which does not release him from his bounden duty to satisfy himself as to the fairness and correctness of the values taken credit for.

With regard to the question of the basis of valuation of stock in trade where questions of taxation are concerned, I submit that the Inland Revenue has no right to dictate what that basis shall be, providing always that it can be shown that the same basis has been consistently adopted from year to year, and that it is not varied without good, sufficient and sound cause. Stocks should not, of course, be deliberately undervalued for the evasion of income-tax or for the creation of hidden reserves ; whether manufactured or otherwise, stocks should be valued on the most conservative basis compatible with fairness and honesty to all parties affected by such valuation.

No one will dispute the lecturer's remarks as to the value of periodical statistics in the conduct of a business. They are, where properly prepared a chart whereby the ship is steered through commercial waters, and any

proprietor of a business of any size, who attempts to conduct it without the aid of such periodical statistics, may be courting disaster, and is in any case not doing his business justice. It is, again, I might point out, no part of the auditor's duty to see that statistical records are kept. All the auditor can do in the absence of statistical records is to show his interest in the business by making a recommendation that it would be all the better if statistical records were kept. •

With regard to the lecturer's remarks upon cash records, and particularly those in connection with the columnar cash book, I do not understand what is meant by cumbering the cash book with cheques drawn on the bank in favour of third parties, and I should be glad if the lecturer could give us some explanation of his remarks in this connection.

I am sure we all agree with the lecturer as to the advisability of keeping a plant ledger, where any considerable quantity of plant is employed in a business. Not only does this afford a ready record for the proper treatment of depreciation, but it is a most valuable aid in dealing with the subject for income-tax purposes, and I have particularly in mind the case of a company which may run a large number of motor cars.

I was interested in hearing the lecturer's reference to George Watson, and at the risk of being personal I might say that the main reason for my interest is that I happen to be an old Watsonian, and on a visit which I paid some years ago to the offices of the Merchant Company in Edinburgh, which administers the fund left by George Watson for the endowment of the hospital referred to by the lecturer, through the courtesy of the secretary, I was able to examine George Watson's bookkeeping exercise books and account books dated from 1674 to 1677. These books contain journal entries and ledger accounts which are written in a hand which would do credit to many an articled clerk or apprentice of the present day, and many of the pages are headed with the motto *Laus deo in Rotterdam*—"Praise to God in Rotterdam," George Watson having learnt his bookkeeping in Holland. I doubt whether the articled clerk or apprentice of to-day views his bookkeeping exercises in the same devotional spirit, so severe are the tests to which the modern articled clerk is subjected before he obtains the qualification which will give him the right and the title to hold himself out as competent to be an auditor or a business consultant, or in the words of the lecturer's paper, an "Aid to Commerce."

Again, in conclusion, I should like to say how very much we have appreciated Professor Annan's paper.

MR. F. J. B. GARDNER, M.C., F.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, in the year 1494 Lucas Pacioli, of Borgo San Sepolcro, addressed a treatise to the Venetian merchants on the subject of bookkeeping as an assistance to their ventures. In the year 1933, 439 years later, Professor William Annan finds it desirable to address the world at large on accounting as an aid to commerce. Lucas Pacioli had eight pages of prefatory matter, a dedicatory epistle to the Duke of Urbino, a survey of contemporary arts and sciences, and of 308 pages only 13 dealt with bookkeeping. Professor Annan in his dedication apologises or rather dismisses the subject as futile to discuss with accountants and then proceeds to mention education, engineering, a homily on auditing and audit practice, agriculture, socks and hose, and after branching off for a little into economies, concludes with the statement that the aim of business should be to make profits. In an International Conference one would have thought there would be some delegates representing that vast concourse of people who when reading a balance sheet feel that it is written in a language which they term "Double Dutch," and, Mr. President, I regret that the Committee of the Conference have so far failed in their duty in omitting to send invitations to the very important body who speak that tongue.

When first perusing Professor Annan's paper I hoped to find some suggestion as to how the professional accountant could come to the aid of that body of the public who are in need of interpretation of so-called "Double Dutch," for it does seem to me that what is required of most business men is a knowledge of how to use their accountants and auditors.

It is not far wrong to say that the majority of business men regard their professional accountant merely as the individual who prepares their annual balance sheet, and if they get into financial difficulties will again come on the scene. The preparation of the annual balance sheet should take a relatively low place in order of importance in the services the professional accountant can render to his client. By the variety of his experience, following on his wide general training, he can, if his client realises how to use him, be of invaluable assistance, and I should have liked to have seen this fact stressed in Professor Annan's paper.

Professor Annan, on page 274, says "The causes of the decline or failure of established businesses is usually the insidious development of unsatisfactory features which may have been long unsuspected." In other words, the onlooker sees most of the game. This is evidenced by an afternoon at Twickenham, when the opposing sides are cheered by the

sound advice of "Feet ! Feet ! Feet !" Professor Annan would have us say "Costs ! Costs ! Costs !"

After all, the professional accountant must be a man of vision. I understand that when a piece of music is played a mental picture appears before the eyes of the trained listener. For example, when the brass instruments blare forth and the bass tambourine and kettle drums make resonant sound the players and trained listeners can actually see the Gods falling out of Valhalla, before parachutes were invented. To the trained eye the balance sheet is not a jumble of figures set forth in "Double Dutch" but a representation of a real and live entity, pulsing with energy, and, we hope, reversing the reference to parachutes, with no kites flying.

Professor Annan does not understate the position when he states we are a Heaven-sent profession, but I am not sure where Heaven has sent us. Hercules was sent to clear up the Augean stable ; have we been sent to clear up the financial chaos of the present day, a task which doubtless we should successfully accomplish, after receiving our instructions in writing, and preparing an audit programme, and engaging another articled clerk or two, premiums payable by the State ?

The accountant comes up against the raw realities of business life and passes beyond the realms of theory. He must be practical, and when Professor Annan touches on education he is dealing with a subject which of itself could form the basis of a vital discussion. I would venture two observations : firstly, during the years of articles the young student must be concerned with the theoretical side. It is when he has passed his final examination that the most important part of his education commences, and it is here I feel that as a profession insufficient provision is made for post-graduate instruction.

The other point I have in mind is that nowadays Universities and other bodies have started facilities for commerce degrees and business training. There are two dangers they must guard against—one, the overburdening of the young brain with a too-heavy load of a mass of subjects, many of a specialised nature, and the second, allowing theory to outpace practical experience.

On page 262 Professor Annan suggests that statistics should show the effects of advertising campaigns. Here surely is a case of theory versus practice. Can statistics alone ever show the effect of an advertising campaign. Key letters, code numbers and what not are all very well, but it is recognised as a practical impossibility to measure accurately a given plan of advertising.

Professor Annan is on safer ground in utilising statistics to find the effect on profits or losses of a restriction on output. When in our heavy industries directors are reduced to quoting on what may be termed "least loss basis"—that is, deciding to accept an order on a basis which though showing a loss incurs a lower deficit than closing down a department or putting it on to a maintenance level—the importance of accurate costing is obvious. *

The modern accountant recognises the important part machines have to play in financial recording. The trouble so often is that the conservatism of employees in old-established businesses prevents or hinders their proper and efficient use.

Professor Annan suggests that we may be inclined to think more about the limitations of our liabilities than the furtherance of our clients' interests. He may recall a certain *cause célèbre* in the medical world as a result of which, I believe, it is almost impossible to get a general medical practitioner to certify a lunatic. The result can be seen to-day ; a world being run apparently by a body of the mentally unstable.

We are a lone profession ; in the church the priest can refer to his bishop, the solicitor to counsel, the soldier to his senior officer, but we, acting with the best will and of honest purpose, get referred to a judge and jury, and subsequently appear before our peers in the form of the Investigation Committee of our respective societies. This latter procedure should be reversed. After we have been judged by those competent to appraise the heinousness of our fault or otherwise then should the judge and jury see and hear us.

As a matter of practice, however, although possibly we may have in the back of our minds our legal liability, we do in fact endeavour to serve primarily our clients honestly, and strive to do our duty.

I do not propose to discuss Professor Annan's treatise on auditing, or whether interest on capital is a charge or not, but I should like him to explain what he means on page 271 by saying "What is the sense of cumbering the cash book with cheques drawn on the bank in favour of third parties ?" As a corollary to that statement, why burden the cash book with cheques received from third parties ? In fact why have a cash book at all ?

In expressing thanks to Professor Annan for his labours in preparing the paper may I express the hope that it may lead the business world to learn how to use their accountants and auditors.

MR. G. T. B. FALL, B.A., C.A. (Great Britain) : Mr. Chairman, my Lord

President, ladies and gentlemen, two most important matters seem to my mind to arise from the paper before us. Both vitally affect our future status, usefulness, and welfare. The Professor has discussed, from the point of view of their future value to commerce, the training of new entrants to the profession ; he has also mentioned the growing tendency of commerce to seek, for the higher commercial posts, men trained in the offices of professional accountants.

With regard to the former point, he called attention to the greater emphasis placed on costing in the examinations of certain of the British Societies. I would, however, remind you that, at least in this country, one of the main claims in favour of our system of training is that it combines practical with theoretical instruction. I personally rate the former exceedingly high. I am convinced that the main reason for the respect which we enjoy in the eyes of the business public is that, while having a very fine theoretical training, we have instilled into us a most useful practical knowledge. I would, however, suggest that modern needs call for a very considerable broadening of the practical side. The difficulties are, I admit, great, but they are not insuperable. I particularly refer to instruction in modern commercial organisation and practice, including especially mechanised accounting, costing, budgetary control, statistics, and similar matters. Practical training on these points is to all intents and purposes entirely lacking as far as entrants to the profession, in this country at least, are concerned.

With regard to men entering commerce as a full-time job, the fact that they are in increasing demand must not be misinterpreted. The larger houses, of the type that employ such men, realise that their training is good up to a point, but sadly lacking beyond that point. Such men are regarded as of value, because their professional training has developed imagination, initiative, and an uncircumscribed outlook, and they are thus receptive and productive ground for the specialist instruction it is still necessary for them to be given, but much of which could have been imparted to them while under articles in the profession.

The commercial community obviously has, as far as we are concerned, two needs of considerable importance. Firstly, it requires practising men who can, from the outside, diagnose, advise, initiate, reconstruct, and generally assist not only in financial and pure accountancy matters, but also in matters of costing, mechanism, and the other points to which I have referred. Secondly, it needs highly skilled accountants as full-time members of its staff. These two needs it is endeavouring to fill from the

ranks of our profession, but it is finding that the men it gets require a considerable amount of preliminary practical experience and instruction. There is, therefore, a tendency for outside specialist societies, whose members receive the training we do not give, to be formed. These, then, are the needs of the commercial community. Does the profession propose to meet them, or are we going to leave those we claim to serve to look elsewhere ?

If I may venture to trespass on your time a few minutes further, I would like to offer a constructive proposal which I submit to be perfectly feasible since the solution of our problem is ready to hand in the person of the qualified accountant already in commerce.

I would suggest that entrants to the profession should be classified in two categories, namely, those who propose to continue in the service of professional firms, and those who will later enter commerce. While the former would be given some practical commercial experience, this would receive much greater prominence in the training of the latter. To this end the system of apprenticeship would have to be entirely changed and the co-operation of qualified accountants in commerce would have to be obtained. In the case of the first class of candidate they would serve under articles with a professional firm for, say, three-quarters of their total apprenticeship, while the second class would only serve for say one-half. It might be necessary to increase the total period of articles. The remainder of their time would be served under a member of their Society employed in commerce, who would, of course, only be allowed to accept such apprentices if he could ensure their gaining a full insight into all phases of commercial activity. They would not be used as clerks to such accountants, but would be trainees under their guidance, studying the general principles of commercial organisation. The examinations of the professional candidates would remain more or less as at present, but for the commercial candidates the examinations would give greater prominence than at present to these special commercial subjects to which I have referred, so that apprentices could receive a portion of their training under the guidance of such commercial accountants.

If such a scheme were instituted, not only the goodwill of qualified commercial accountants would have to be enlisted but their status and needs would require careful consideration. They could not be left in their present rather isolated position, for now, in this country, at least, directly they join a commercial house they become practically outcasts from amongst their professional brethren.

I would suggest that provision should be made in all societies for specific representation on their councils of this large section of the profession, probably in the ratio of their numbers to the total membership. Their post-qualification needs for continued study of modern problems should be met by carrying out something in the nature of the Professor's idea with regard to courses of research, and making the findings available to all members. This alone would be most invaluable, for the commercial accountant has one disadvantage under which his professional brother does not labour, and that is that he only has the experience obtainable from a study of the problems of his own one firm or series of allied firms, and thus his outlook tends to become rather cramped.

May I venture to thank the Professor for his remarks and to hope that our profession will recognise that industry wants our help, if we are properly equipped, but if not will turn elsewhere, and that therefore the time has come when an upheaval of our ideas and training must be undertaken if we are to continue to be "an aid to commerce."

MONS. LE PROF. G. L. TRANCU IASY (Roumania) spoke in French : Mr. Chairman, my Lord President, ladies and gentlemen, the problem of accountancy as expounded by Professor Annan is one of the most interesting that accountancy has in its profession.

This problem interests me in my quality as Professor at the Academy of High Commercial Studies and at the Ecole Supérieure de Commerce in Bucharest. We prepare the new generations who will be the accountants of the future. We ought therefore to prepare the way that our successors should follow in the struggle for business.

From the point of view of the adviser of the business man, this role surpasses the activity of a single undertaking. Through his business a commercial man enters into the economic life of the State. The accountant, therefore, is the liaison between the business man and the entity of the State from the point of view of finance and judicial relations. I see with great pleasure the interest that our Congress takes in this problem.

I seize this occasion to pay my homage to the organisers of this Congress, which will prepare the new economic life where practice cannot go without theory and where theory, as we have had many examples before us, can do nothing without the profound knowledge of how to do it. I will plant deep into the souls of my pupils my heartfelt impressions of London and the valuable work of this Conference, and I am sure that the harvest will be satisfactory for future generations.

I, as an Honorary President of the Roumanian Delegation, am very

much in favour of the proposal made by the Italian delegate that the next Conference should be held at Rome.

MR. A. W. TORY, F.L.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, I would preface my few remarks by expressing appreciation of the comprehensive manner in which Professor Annan has dealt with his subject.

The client of yesterday was quite satisfied to have an annual balance sheet covering the whole of his activities, and usually he did not know till the balance sheet was made up whether his year's working had been profitable or not. To-day he wants to know his position from week to week, or at least from month to month, and a proper system of accountancy will reveal it to him.

Again, in large-scale businesses he does not want to know merely the total profit or loss. He wants to know what each department has done. He may want to know the production cost of a given item. He wants to know how expenses in one department compare with those in other departments and with those in the same department for previous years. He is not satisfied to feel the main pulse of his creation ; he wants to feel the throb of life in every member ; he wants to dissect these members, probe about in them for signs of weakness, or wasting, or decay, try the effect on them of special tonics, such as advertising, find if they pay for scientific feeding with new machines or methods. He wants intelligent forecasts of what the result will be if he lops off a member or grafts on new ones. He wants to be able to have a complete picture of the whole creation given to him at short notice whenever he calls for it. And all these wants are satisfied by up-to-date accounting. What his thermometer, stethoscope, and all his other scopes are to a doctor, what compass, barometer, chronometer and sextant are to a sea captain, that, and more, accounts are to the business man. But they must be properly organised and kept accounts.

Industry requires of accountants not merely to be atom smashers, but rather to be X-ray merchants. The responsibility of practising accountants towards commerce is great, and this Conference will prove invaluable in focusing that responsibility.

MR. W. F. EDWARDS, A.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, only by making itself of value to commerce can the profession of accountancy progress. Its rate of progress depends on how well and how quickly it educates the commercial world to appreciate the value of, and the necessity for, enlisting its

services in management. Too often is it believed that its chief functions are those relating to auditing and income-tax. No effort should be spared by the profession itself to show how it can not only assist but actually and actively participate in management, with benefits to commerce and the whole community. Small concerns should realise that capable financial management is often of *more* importance to them than it is to large concerns, as most small concerns experience especial difficulties which arise as a result of trading with insufficient capital. In commerce it is not generally, and hardly ever fully, appreciated how valuable and essential to the welfare of any business are the qualifications and experience of a trained accountant. In this country some progress has been made towards getting boards of directors to realise the value of a capable financial executive whose comments and views are acted upon—as well as listened to—but the rate of progress leaves much to be desired. I feel very strongly on this subject as I have for some years past had experience of American businesses and of how important they consider it to be to have available full information on the trend of sales volume and costs, expenses, and the capital invested in the business. All such information is closely studied with a view to seeing where performance—and net profits—can be improved.

In this country many bearing the titles of accountants in business are acting merely as expert bookkeepers; they are forever engaged in putting in what they believe to be their correct places in the books the various figures which result from the daily transactions of the concern. Furthermore, even this task is not tackled aggressively; the work gets in arrear and the final figures are produced so late that they prove of little or no use to the executive in aiding them in the formulation of a policy for the ensuing period. The average business executive must be educated to realise that the full benefits, and profits, from a satisfactory sales volume are obtained only where there is also efficient financial control and planning. If as much care was exercised in the choice of a finance manager and if the views of the finance manager were acted on as readily as are those of the sales manager, more profits would be made and many losses would be avoided.

Some professional accountants still remain unconvinced that regular accounts for the shortest period possible are necessary to the efficient conduct of a business. Even where they agree they are necessary they often believe it to be impossible to prepare them promptly without incurring excessive cost. It will be found in practice that where accounts,

previously prepared only annually, are prepared, say, quarterly, the additional information so gained will be found so valuable that monthly accounts will be considered even more beneficial. Where monthly accounts have been prepared—and have been used—for a considerable period it will be found that the business is under such excellent and close financial control that a reasonably accurate forecast of results for some months ahead can readily be prepared. Where such forecasted results are unfavourable they should not be adopted by the executive as their objective until all possible steps have been taken, there and then, to adjust the revenue and/or the expenditure for the forecast period. In certain circumstances—but not as often as many executives lead themselves to believe—such immediate adjustments may be possible but not advisable. The executives are then possessed of the information that a loss *will* be made, that it *could* be avoided, but that they have decided, as a matter of policy, that no action shall be taken. A business managed on these lines will always be healthy and more prosperous than those of its competitors who are without such knowledge.

When discussing this matter I have often been told that the average business in the United States is larger than here, and it can therefore afford to have efficient financial control. The answer is that no business can afford to be without it. No business, however small, will prosper and make maximum profits—or minimum losses—unless the importance of financial management is fully realised and the duties pertaining thereto are entrusted to a person capable and qualified to discharge them. Where the business is so small that it really cannot afford a trained accountant on the staff the auditor should endeavour to arrange that his services are enlisted as financial adviser, as distinct from auditor. Too often is it considered in a small business that the only use for the professional accountant other than to conduct the audit is to act as a cheque signatory, as a precaution against fraud. This is a poor use to which to put the knowledge and experience he possesses, and could apply, were he permitted, to the benefit of the business and its owners. The accountant is too often told he does not appreciate the technical aspect of the problems upon which he is commenting and his views are usually discounted and often ignored as a result of this lack of technical knowledge. This attitude indicates a confusion of thought on the part of executives. A business lacking technical direction at the top is less likely to fail than one lacking financial direction. For efficient management both are required, but in actual practice many persons with technical knowledge and some money

consider they are well qualified to run the financial side of a business.

THE CHAIRMAN: My Lord President, ladies and gentlemen, before I call upon Professor Annan and Mr. Ashworth to wind up the discussion of their papers, I hope you will forgive me if I occupy one or two minutes in referring to Professor Annan's paper, and particularly to the subject of education, a theme to which prominence is given throughout the paper. I am glad that this is so because I have noticed lately a tendency in certain quarters to disparage the value to our students of a University education. This, to my mind, is very regrettable, for whatever our views may be about a University education, I think few will deny that it has the great virtue of teaching a man to think for himself. In these days of strenuous and increasing competition, the value of a broad and independent outlook in the conduct of any profession is incontestable. Particularly is this true of our own profession of accountancy: as the Professor points out, the range of services offered by the accountant of the future will inevitably be very much wider than it has been in the past. The change, indeed, is already taking place: not only must the successful accountant be well founded on the theoretical and practical sides of accounting, he must in addition have a comprehensive knowledge of industry in all its phases, and he must be able to advise in the management of a business. He must, in short, be ready and able to make himself conversant with matters outside the strict confines of his own profession if he wishes to give the full value of his services. In the past it may perhaps have been sufficient to accept facts and statistics as they were placed before him; now it seems to me essential, so complicated are modern industrial problems, that he should if possible acquire some practical knowledge of the business to which these facts and statistics are related and so be in a position to check them. The accountant, I am sure you will agree, must take a larger view of his profession, and this applies to his dealings with all business, both great and small.

We are forced, then, to recognise the need for education in the fullest sense of the word, and here it is that the benefits conferred by the Universities become most apparent.

I am very glad to notice the professor's reference on page 275 to research, because, may I say finally, it is a subject in which the accountancy bodies must and should be deeply interested. I cannot imagine that there is any real ground for his apprehension that the resources of commerce would not freely supply the funds necessary for the scheme that he has in mind. I will now call on Professor Annan to reply.

PROFESSOR ANNAN : Mr. Chairman, my Lord President, ladies and gentlemen, I have such a short time in which to reply that you will excuse me if I am very brief in my remarks. It is impossible to touch on one half of the points that have been raised by the numerous speakers, ranging from my friend Mr. Banks, with his illustration, from the treetops of Maine, to those two " children " of George Watson who came down from Edinburgh to London and remained there and who gave us the benefit of their remarks this afternoon. The object that I had in view in writing the paper was to bring out the importance of accounting, more particularly to small businesses, and to show that the superiority in numbers of small businesses is a real thing, I might mention that during the last 13 years, limited companies of £50,000 capital and under were formed and registered to the number of 114,000, against companies in Great Britain of £50,000 and over of some 8,000 only. That, I think, indicates the superiority in numbers of small businesses and the need for accountancy in regard to them is correspondingly great. I can only touch on two points that were mentioned and which I am glad to see were emphasised. First the question of tuition : It has been suggested that there should be some teaching in schools to prepare students for the work of accounting and cost accounting. Mr. Dunkerley, I think, in opening the discussion referred to that. May I say with all deference that I think it would be a good thing to introduce in the schools a broad study of business economics and finance to take the place of much of the teaching of bookkeeping that is done in schools at the present moment. I may be wrong, but I rather think that the bookkeeper of the present day is not being properly taught. For example, he looks upon balancing his books at the end of the year as the one thing of paramount importance. It is not his fault ; he has been taught to do that. I think the tuition of the bookkeeper of the future should be more on the lines of the suggestions which I have made in the paper—rather to tell him how to get out figures daily, weekly and monthly. We accountants must try to tell our clients in figures the results of their operations as they occur.

It has been said by one of the speakers that sometimes we do not give our clients matter that they could understand, and he advocated a greater use of charts. I am afraid I have no time to enlarge on that point, but I have some views about it. Charts are all very well, but they have to be very carefully prepared ; you must not put too much in them, otherwise they lose their effect ; but a wise accountant will, in addition to supplying the figures, furnish a chart when necessary.

It has also been said that I have been somewhat confused in dealing with the auditor's position and the position of the advisory accountant, Mr. Myers, I think, said that it would never do for an accountant to prepare a lot of figures without being instructed and then to ask his client to pay his fees. I agree. I suggest that these figures should be brought out for the help of the client, that it should be done by arrangement between the client and the accountant, but that the offer to do so should come from the accountant.

In conclusion, I should like you to make careful note, please, of the concluding remarks of the Chairman. I am glad he stressed the point that I made about instituting some research work in accounting methods. I think that is important. We find research in all sorts of scientific subjects. Business is a science, accounting also is a science now, and I suggest the time is ripe when research work should be commenced. For myself, I have been a student of accounting for longer than I should like to say, but the humblest day that I have in the week is the day when I read the weekly issue of *The Accountant*. It shows me what a vast amount of knowledge there is to acquire, it shows what a vast extent accounting matters cover, and I feel when I have read it that I know very little indeed about accounting. In Scotland we have an issue once a month of what is called *The Accountant's Magazine*. That magazine makes us more humble still because, in addition to all the weekly and daily matters of interest, we are given the examination questions of the examining bodies in Scotland, and if anyone wants to feel humble in their accounting work, I should recommend them to read those examination papers.

I wish, in conclusion, to thank you for the way you have listened to the paper, also those gentlemen who have made remarks upon it. I thank you, ladies and gentlemen.

MR. ASHWORTH : Mr. Chairman, my Lord President, ladies and gentlemen, I am very anxious not to trespass upon the time which has been allocated to my friend Mr. Hewetson Nelson, who is to read the next paper, so I will be as brief as possible. As a matter of fact, there is very little to which I have to reply, because everyone has been so exceedingly kind to my paper.

Mr. Polak made reference to the question of machinery and internal check. My experience has been that accounting machinery and mechanical accounting systems assist and develop internal check and do not place any hindrance to the various checks which the auditor may desire to put into operation. I am very glad that Mr. Polak stressed my remarks

upon the advisability of carefully planning and continually overhauling the mechanical accounting work. It is certain that, unless the work and system of mechanical accounting is under the constant supervision of the accountant, trouble will ensue, mainly by reason of the fact that the detail will become stereotyped and excessive. Congestion of the machines will result and the accountancy expense will grow enormously. I would like to assure Mr. Polak that there has been no "slip of the pen" in my reference to daily balances. Mr. Dunkerley, who has had quite considerable experience in this direction, has just told us that he is able to prepare his accounts and have them ready for submission to his Board within two or three days after the end of the accounting period. I, myself, have obtained similar results. That could not be done economically without machinery and without daily balances.

Mons. Kamil Augsten also supports my remarks with regard to daily balances. Then again, in these days credit, both received and given, has to be carefully and constantly supervised by the management. The preparation of daily balances of bought and sold ledgers is a very useful aid in this connection.

Professor Annan has had quite a number of interesting things to tell us about accounting as an aid to commerce, but the point I would stress is that enlarged upon by Mr. Gillett, who emphasised the need for the closer association of the accountant with management. This is a point in which I feel that our profession should be intensely interested, because I believe the future of our profession will include the audit of management, which, in my opinion, is seriously required in the present day. We should, therefore, I think, begin to equip ourselves for that task.

I thank Mr. Scott-Moore for the kind things he has said about my paper, but I do not agree with him when he compares interpretation of accounts to the psychic. I see nothing psychic about interpretation. Interpretation is the essence of the accountant's work. A bookkeeper is no good as an accountant, although we have many people posing as accountants who are, in effect, nothing more nor less than bookkeepers. The distinction between the accountant and the bookkeeper, in my opinion, is that the former must be an interpreter of results.

Mr. Scott-Moore also refers to the question of intelligence of operators. I find, and have found, that a greater degree of intelligence is required by machine operators. They have got to be able to do something immediately on those rare occasions when things go wrong. Of course, there is not yet a perfect system under the sun; at least I have not met it.

The machine operators require a keener grasp of their job than the book-keeper does under the ordinary bookkeeping rule-of-thumb methods, where every debit and credit has its proper place, because there is the manipulation of the machine to be considered.

With regard to the strain on the nervous system, I have never yet had a case of collapse, although I do admit that if the operators are not properly trained—a point emphasised in my paper—there is a possibility of their getting panicky when things go a little wrong, which is not conducive to proper nervous health and usually makes confusion worse confounded.

With regard to Mr. Witty's remarks, I can only say "Thank you." He has been extremely kind and generous in what he has had to say. I only hope that my paper has increased thought in our profession, not only on the question of mechanical accounting, but also on that of the relationship of the profession to management and I hope that some good will come out of my humble effort. Thank you.

THE CHAIRMAN: That concludes the meeting, ladies and gentlemen.

WEDNESDAY, 19th JULY, 1933

Afternoon Session

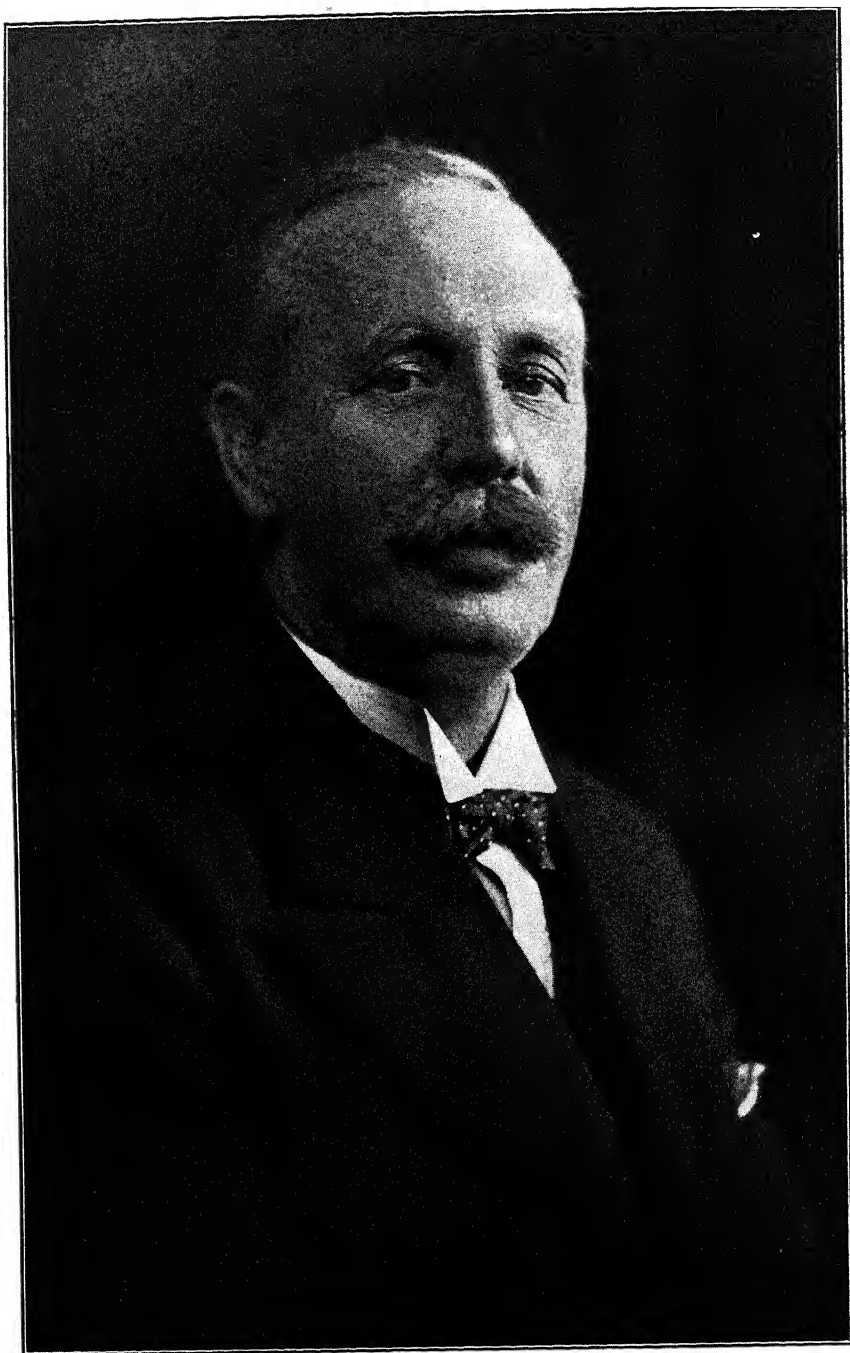
CHAIRMAN: Mr. T. H. HUGHES, F.C.R.A. (*President of the Corporation
of Accountants*).

HONORARY { Mr. JOHN HYDE (Canada).
CHAIRMEN { Herr C. SOMMERSCHILD (Norway).

PAPER

“ Capitalist Combinations in Industry in the Light of
Present-Day Needs ”

MR. C. HEWETSON NELSON, F.S.A.A.



[Photo by Lafayette Ltd.]

MR. T. HERBERT HUGHES, F.C.R.A., F.I.S.A.

CAPITALIST COMBINATIONS IN INDUSTRY IN THE LIGHT OF PRESENT-DAY NEEDS

BY

C. HEWETSON NELSON, F.S.A.A.

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BIBLIOGRAPHY.

A CENTURY'S PROGRESS

1. It is well, in times like the present, to recall that our predecessors faced as intense a depression, and difficulties relatively as great, as those which confront the nations of the world to-day.

"The present moment is one of great distress," wrote the *Edinburgh Review* in 1830, "but how small will that distress appear when we think over the history of the last forty years : a war, compared with which all other wars sink into insignificance ; taxation, such as the most heavily taxed people of former times could not have conceived ; a debt larger than all the public debts that ever existed in the world added together ; the food of the people studiously rendered dear ; the currency imprudently debased, and imprudently restored. Yet is the country poorer than in 1790 ? We fully believe that, in spite of all the misgovernment of her rulers, she has been almost constantly becoming richer and richer. Now and then there has been a stoppage, now and then a short retrogression, but as to the general tendency there can be no doubt. A single breaker may recede, but the tide is evidently coming in.

"If we were to prophesy that in the year 1930, a population of fifty millions, better fed, clad and lodged than the English of our time, will cover these islands—that Sussex and Huntingdonshire will be wealthier than the wealthiest parts of the West Riding of Yorkshire now are—that cultivation, rich as that of a flower-garden, will be carried up to the very tops of Ben Nevis and Helvellyn—that machines, constructed on principles yet undiscovered, will be in every house—that there will be no highways but rail-roads, no travelling but by steam—that our debt, vast as it seems to us, will appear to our great-grandchildren a trifling encumbrance, which might easily be paid off in a year or two—many people would think us insane. We prophesy nothing ; but this we say—if any person had told the Parliament which met in perplexity and terror after the crash in 1720, that in 1830 the wealth of England would surpass all their wildest dreams—that the annual revenue would equal the principal of that debt which they considered as an intolerable

burden—that for one man of £10,000 then living, there would be five men of £50,000 ; that London would be twice as large and twice as populous, and that nevertheless the mortality would have diminished to one-half what it then was—that the Post Office would bring more into the exchequer than the excise and customs had brought in together under Charles II—that stage-coaches would run from London to York in twenty-four hours—that men would sail without wind, and would be beginning to ride without horses—our ancestors would have given as much credit to the prediction as they gave to Gulliver's Travels. Yet, the prediction would have been true ; and they would have perceived that it was not altogether absurd, if they had considered that the country was then raising every year a sum which would have purchased the fee-simple of the revenue of the Plantagenets—ten times what supported the Government of Elizabeth—three times what, in the time of Oliver Cromwell, had been thought intolerably oppressive. To almost all men the state of things under which they have been used to live seems to be the necessary state of things. We have heard it said that five per cent. is the natural interest of money, that twelve is the natural number of a jury, that forty shillings is the natural qualification of a county voter. Hence it is that, though, in every age, everybody knows that up to his own time progressive improvement has been taking place, nobody seems to reckon on any improvement during the next generation. We cannot absolutely prove that those are in error who tell us that society has reached a turning point—that we have seen our best days. But so said all who came before us, and with just as much apparent reason. ‘ A million a-year will beggar us,’ said the patriots of 1640. ‘ Two millions a-year will grind the country to powder,’ was the cry of 1660. ‘ Six millions a-year and a debt of fifty millions,’ exclaimed Swift, ‘ the high allies have been the ruin of us.’ ‘ A hundred and forty millions of debt,’ said Junius, ‘ well may we say that we owe Lord Chatham more than we shall ever pay, if we owe him such a load as this.’ ‘ Two hundred and forty millions of debt ! ’ cried all the states-

men of 1783 in chorus—‘ what abilities or what economy on the part of a minister can save a country so burdened ? ’ We know that if, since 1783, no fresh debt had been incurred, the increased resources of the country would have enabled us to defray that burden at which Pitt, Fox and Burke stood aghast, to defray it over and over again, and that with much lighter taxation than what we have actually borne. On what principle is it, then, when we see nothing but improvement behind us, we are to expect nothing but deterioration before us ? ”

2. Time has amply justified the *Edinburgh Review*. Despite present anxieties, we look back on a century marked by great social and material progress. Concurrently there has been a rapid growth of large scale enterprise and capitalist combinations in industry, commerce and finance.

In facing the task before me, therefore, I start with the assumption that capitalist combinations are a genuine attempt to improve the trade of the world, to provide the reasonable reward of capital, of enterprise, and of labour, and to improve the general welfare of the people.

3. While endeavouring to face the problem squarely, we must not forget that it is one of those questions in which the short view may well prove a wrong view. To quote a single illustration, we have consistently heard of the dangers of centralisation, and have noted, with some measure of relief, that more recently the principle of decentralisation has begun to operate in several important mergers. The explanation is not necessarily the obvious one, namely, that “ the dead hand of centralisation ” has proved a failure. Rather the position has been that, with a view to investigating thoroughly the practices of many departments or works, centralisation as a temporary expedient was necessary, in order, at a later stage, to apply the principle of decentralisation as the permanent policy. Even then exceptions are necessary, as very naturally the accounting must be largely centralised.

4. Still speaking in general terms, I am not unconscious of the fact that the law of diminishing returns applies to other worlds than that of agriculture, and that a capitalistic combination may become so top-heavy that the additional dose of organisation, or new capital,

fails to produce adequate profits. It is a question of discrimination, and of very delicate discrimination, to determine the psychological moment at which to stop. And having determined it, where is the executive which has the courage to stop? It is so much easier to let the snowball go on, growing bigger and bigger, adding million to million, until the inevitable happens, and safety, at any rate temporary safety, is found in a writing-down scheme.

5. Table I of the statistical data which conclude this paper indicates that during the four years 1928-31, an analysis of twelve companies reconstructed in that period shows that out of £37,587,772 paid up capital, £28,693,930 (76 per cent.) required to be written off, and new capital obtained to the extent of £8,769,617.

HUMANISING MASS PRODUCTION

6. There are evidences of an unquiet mind in regard to the reconciliation of adequately large scale and efficient production with the claims of personality and human life. Lord Irwin, speaking in Yorkshire in July last, directed public attention to the subject. He pointed out that there were people who denied that large scale production and the nobler human interests can exist side by side, and that mass mentality must, in the long run, be fatal to individualism. It was evidently the same kind of thought which was at the back of the minds of the writers on "International Industrial Agreements" (League of Nations, Geneva, 1931), when they warned executives of the grave responsibilities incurred by pursuing misguided policies. But even that publication does not specifically touch the question raised by Lord Irwin, although it discusses elaborately the lowering of production and selling costs, the advantages of the quota system, the maintenance of the balance between production and consumption, the effects of industrial agreements on consumers, and the fact that success in all these matters guarantees the worker "a much higher degree of security than isolated undertakings which are more exposed to the ups and downs of a period of economic instability and insecurity."

7. I am, of course, aware that in many of the larger mergers, including Imperial Chemical Industries, a department is set aside

under a capable head, which is specially charged with the welfare of the workers, and observation during visits to various works has indicated to me the large measure of success which has attended the labours of these departments. In fact, so great has been that success, that I well remember a well-known Labour leader declaring to me his abhorrence of welfare organisations for the workers on the ground that they delayed the nationalisation of the means of production.

It will be remembered that the late Lord Melchett insisted upon maintaining personal contact with his workpeople, and for this purpose established his system of Works Councils.

The work of the National Institute of Industrial Psychology, in its many-sided activities, is undoubtedly rendering a national service of first class importance at the present time.

THE ORIGIN AND DEVELOPMENT OF COMBINES

Competition and Regulation.

8. I propose to give the widest interpretation to the word "combine" (with some subsequent and closer definitions). I include all commercial, industrial and financial organisations, which comprise the fusion or active co-operation of common interests within some regulative scheme of operation, whether loosely formed or closely knit. Combines vary from informal associations of business men, having in view some mutual regulation of their trade or industry, to world-wide organisations, controlling successive stages of production and distribution, from raw material to the retail sale of the finished product.

9. The regulative as distinct from the purely competitive principle of trade and production has an ancient and historic origin. I suspect that Joseph, as corn controller of Egypt, was representing a powerful food combine which affected a substantial portion of the then known world. The ancient guilds in Great Britain and the Continent of Europe controlled industry and trade, in their then very limited sphere, by regulation and co-operation, thus restraining competition. To-day the small manufacturer or trader who increases the number of his establishments is simply applying in a limited degree

the idea of rationalisation and of combination. By utilising his own directing force and initiative over an extended area of trade, he hopes for an expansion of turnover and profits without increasing his prices.

Thus, through history, commerce and industry have been shaped and governed by free competition on the one hand, and by regulation and combination on the other. That is equally true of modern private and capitalistic enterprise.

10. In 1919 the Committee on Trusts set up by His Majesty's Government in Great Britain reported as follows: "We are satisfied that trade associations and combines are rapidly increasing in this country, and may within no distant period exercise a paramount control over all important branches of British trade."

In a report issued by the Economic and Financial Section of the League of Nations on Industrial Agreements in 1930, the Committee stated, "We are witnessing the creation of industrial, commercial or financial organisations on a colossal scale, utilising an enormous capital and extending their activities over the whole world."

11. The operations and activities of combines have forced themselves upon public notice generally, in addition to the close attention which is regularly given to such movements in official and business quarters. The subject is peculiarly appropriate for an International Congress on Accounting by reason of the international scope and influence of combines, and because our professional advice may be sought in regard to their constitution and operation. The anticipation of the Committee on Trusts in 1919 has proved substantially accurate, and the organisation and activities of combines are producing changes in commerce and industry profoundly affecting the economic and social life of western countries. The daily life of every person in these islands, particularly in the urban areas, is touched at some point or another by the activities of a combine.

Natural Monopolies in Great Britain.

12. Transport and public utility enterprises must inevitably be permitted a substantial measure of monopoly within their own spheres. Unrestrained competition would be practically impossible and financially disastrous. Even in that heyday of competitive enterprise, the nineteenth century, the railway companies were estab-

lished by Acts of Parliament, and endowed with both privileges as to their powers and regulations as to their services and charges to the public. The railway company at its inception was not necessarily a combine, but it had to operate what was necessarily a monopoly.

13. In Great Britain there is in effect Parliamentary regulation of natural monopolies, since all companies launched to carry on public utility undertakings must be constituted by special Acts of Parliament. On the other hand, coming to more recent years, large combines in various industries have been established. They are not subject to any special legislation applicable to combines, but are constituted under the Companies Act, and their operations are subject to common law.

Period 1900 to 1914.

14. It is difficult to assign any exact date when the trend towards combination started in Great Britain, but combinations had made a definite impression on industry and commerce during the later part of the nineteenth century. In 1907 there was published a work by Mr. H. W. Macrosty on the Trust Movement in British Industry, which gave descriptive accounts of various forms of combines in nine groups of industries and trades, but extending to a large number of undertakings. Nevertheless, during this period the dominant force in industry and commerce was still individualistic and competitive.

The War Period:

15. During the Great War the whole organisation and machinery of production were subjected to abnormal pressure under the driving force of government and necessity. There was immense speeding up of invention, technique and organisation, leading to mass-production over wide areas of industry. Conditions were exceptional, and in spite of suggestions to the contrary, it would be irrational for war-time pressure and organisation to be resuscitated in the normal times of peace. The human strain was too great, and intense activity gave way to a reaction, begetting serious industrial consequences.

Period 1920 to 1932 : The Rise of Rationalisation.

16. At the same time the industrial experiences of the war period were not lost ; they had in fact produced a radical change of attitude. There was less universal adherence to the doctrine of free competi-

tion, although the idea of combination generally was still not free from prejudice in the public mind. "Trusts" had not lost the sinister implication derived from the anti-trust campaign in America in the 'nineties. Those trusts, it was alleged, thrived upon exploitation of the consumer and adopted business methods which were open not only to legal but to serious moral objection. In Great Britain, apart from a spasmodic attempt to limit post-war profiteering under the provisions of an Act of Parliament (whose power and operations quickly expired), no anti-combine legislation has been invoked.

17. Combination in industry cannot be adequately considered without some attention to the question of rationalisation.

The slump of 1920-21 (in intensity not comparable to the present position) arose from the general over-production which took place after the war. This position demanded immediate action. The idea of rationalisation, which developed first in Germany with a view to the reorganisation of German industry, took root elsewhere. Industrial organisation in Germany is now substantially based on rationalisation, operating for the most part through cartels.

18. The great prosperity in the United States of America was characterised by a wide extension of combination, mass-production, high output and intensive sales. Obviously a country which produces 62 per cent. of the world's cotton, 61 per cent. of its petroleum, 40 per cent. of its copper, 37 per cent. of its coal, 34 per cent. of its pig iron, 38 per cent. of its steel and 45 per cent. of the world's electrical energy has much to teach us in the matter of scientific management.

In Great Britain rationalisation was considered, but applied with caution and accepted with limitations and reserves. The last decade has been marked everywhere by rapid progress in science, invention, transport and organisation, lending themselves to the application of rationalisation in industry. Impelled by these forces and by economic instability, the combination movement has exhibited remarkable impetus. Finally, in the report of the Committee on Industry 1927, under the auspices of the League of Nations, a definite recommendation was made for the application of rationalisation to industry.

19. This report stated that the rational organisation of production and distribution was one of the principal factors in increasing output,

improving conditions of labour and reducing costs of production. Its purpose was to secure the maximum efficiency of labour with the minimum effort, to facilitate research into methods of manufacture and to encourage the use and replacement of standard parts ; to eliminate waste of raw material and power, to simplify unnecessary transport, excessive financial burdens and the useless multiplication of middlemen. Its ideals were to afford the community greater stability and a higher standard of living, to lower prices of goods adapted to the consumer's needs, to secure a fair and reasonable profit and a fair distribution of it.

20. To the accountancy profession these are familiar principles, the application of which it has constantly recommended. Although the Committee did not say so in specific terms, it has come to be assumed that combination of units in an industry is a first essential to rationalisation. There has been the assumption that the small undertaking is more or less inefficient, and that the principles of rationalisation are incapable of application on a small scale. Such a generalisation in my view is not always tenable. I suggest that rationalisation requires to be seasoned with considerable discrimination.

Rationalisation has undoubtedly been a powerful stimulus to the development of combinations in the last ten years, but a number of combinations have taken place which were not necessarily a response to any sound economic principles, but seem to have arisen from the conjunction of opportunity and leadership.

RATIONALISATION

21. In the year 1928 Dr. W. H. Coates asked, " What is to be understood by this term ? " and in reply quoted with approval the summary given in " Scientific Management in Europe " (International Economic Conference, Geneva, 1927) :—

" Study of methods for stabilising production and employment.

" Standardisation (normalisation, unification, simplification).

" Elimination of waste.

" Horizontal and vertical combination ; national and international industrial agreements, cartels, trusts, syndicates ;

action by governments, by public services, by employers' and workers' organisations.

"Specialisation ; mass-production and distribution ; study of the general problems of the distribution of raw materials, the organisation of markets, transport power and labour supply."

FORMS OF COMBINATION

22. The variegated character of industrial and commercial combinations is remarkable. A combine may be carried on simply by casual meetings of those engaged in the same trade, perhaps locally, with hardly any link of effective organisation. At the other extreme, we find the most highly centralised manufacturing and distributing concerns, international in scope and operations. The methods employed to make combines effective are numerous, and it is difficult to generalise in regard to them. Three main divisions, however, seem to have emerged.

23. First there is the Terminable Association, which is a loose association of representatives of a common trade or industry, or of undertakings engaged in various branches of the same or cognate industries. These associations frequently are not constituted as legal entities, but they have sometimes been the most effective in their practice. They have been the subject of some criticism by the public, which views with suspicion and dislike any organisation which might be described as a "ring." Their work has been limited to methods of selling, prices and trade conditions. Sometimes, but less often, they have arranged for an exchange of views on problems common to the trade, but for the most part they have been concerned with the maintenance of prices or the protection of producers against unfair or cut-throat competition.

24. In the next division we find combinations partaking of the character of cartels, more commonly called Pools in Great Britain. " ' Cartels ' are associations of independent undertakings in the same or similar branches of industry established with a view to improving conditions of production and sale. They are called ' syndicates ' or ' comptoirs ' where they have set up a common sales organisation." (League of Nations Memorandum on International Industrial Agreements, 1931.)

The agreement between undertakings constituting a pool or cartel is more closely defined than in the case of terminable associations, and the cartels are frequently national or even international in character. (For example, the Rubber Restriction Scheme and the European Aluminium Cartel.)

25. In the third division are combinations proper, which in America are usually described as "mergers"; in Great Britain the term "combine" has also been employed. Combines in America were originally operated by trusts, but the method of trusts (the surrender and concentration of voting power) is now obsolete and was prohibited by the Sherman Law and Clayton Acts. Combines generally consist of a parent company (which may or may not be an operating company in itself) enlarged by its own progressive expansion or by the direct amalgamation with itself of other undertakings; alternatively amalgamation may be effected by a new company purchasing outright a number of other small companies which cease to exist. More usually, the parent company acquires the whole or the majority of the shares of other undertakings, the policy of which it controls, and their operations are brought for all practical purposes within its ambit. At the same time, these subsidiary undertakings retain their separate legal existence as companies. In Great Britain we have become familiar with the idea of the holding company and its subsidiaries.

26. A distinction must be made between a "horizontal" and a "vertical" combination. A horizontal combination is a group of undertakings engaged in the same trade at the same stage of production, for example, a drapery combine, or the European Aluminium Cartel. A vertical combination consists of the combination into one organisation of different undertakings, carrying out successive stages in production, from the raw material to the finished article, or even to the retail sale to the consumer. For example, a single aluminium holding company might control—

- (a) a company for producing and shipping bauxite (the raw material);
- (b) a company carrying on the manufacture of alumina (the pure oxide of aluminium);

- (c) a hydro-electric company for supplying power ;
- (d) an aluminium smelting company to operate electric furnaces for extracting the metal from its oxide ;
- (e) an aluminium rolling mills and foundry company ;
- (f) a company carrying on the manufacture of aluminium utensils and parts ;
- (g) a company for carrying on the sale of aluminium domestic utensils to distributors or to the public.

THE ORGANISATION AND FINANCE OF COMBINATIONS

27. In practice a combine may be formed by—

- (a) outright amalgamation with other companies ;
- (b) the formation of a holding company controlling subsidiaries ;
- (c) a profit-sharing pool ;
- (d) selling associations.

Amalgamations.

28. Amalgamations have the advantage of definiteness and permanency, but practically it is rather more difficult to effect an outright amalgamation than to use one of the other methods. Amalgamations also involve technical and legal considerations in regard to the transfer of fixed assets. An amalgamation may take place by company A. acquiring company B., or company B. acquiring company A., or a new company C. acquiring company A. and company B. The method of amalgamation must be carefully considered. I would particularly mention three aspects :—

- (a) the control of future policy ;
- (b) the ratio of fixed interest and fixed dividend-bearing capital to the whole capital of each of the companies ;
- (c) the rates of fixed interest and fixed dividend to be borne and the terms upon which such capital is to be repaid in the event of winding-up.

By the retention in the amalgamation of blocks of debentures or capital bearing a low fixed rate of interest, the advantages of the combination would accrue to the equity shares, since a heavy new commitment for the repayment of such capital would be thereby avoided.

Holding Companies.

29. A holding (or parent) company can acquire the shares of a number of other companies. The parent company may itself be an operating company. Alternatively, a new holding company may be formed to acquire the capital of all the companies to be formed into the proposed combine. Each company involved remains a legal entity, but the control definitely passes to the holding company and the actual business policy of the subsidiary companies will inevitably be changed, having regard to the interests of the combine as a whole.

Pools.

30. A pool is generally effected by an agreement for the profits of each of the companies (or firms) concerned to be combined into a common fund and distributed in the ratio laid down in the agreement. The ratio of distribution is generally based upon past performance. This may be accompanied by some arrangement as to the operating and selling policy of all those units in the pool. This is the least expensive method of effecting a combine. There would probably be a joint committee to manage the pool. The agreement being for a period of years, its renewal may become the subject of delicate negotiations. Moreover, towards the end of the period, constituent companies in their policy may have undue regard to their interests in negotiating a renewal.

It will be recognised that a number of accounting questions must arise in regard to the computation of profits, the treatment of depreciation, directors' fees and the employment of new capital. These matters, if not carefully handled, may lead to awkward disputes.

Selling Associations and the Rebate System.

31. The method of selling associations is familiar in connection with the German cartel. These associations generally operate by fixing percentage quotas for the various units in the combine, and by a geographical division of markets. While the total output of the combine may not be fixed, each unit has to make a return of its output or sales for a given period. Compensation has to be paid to a pool when the percentage quota is exceeded, and compensation is received when the quota has not been reached. In such cases it may

well happen that it will pay an individual unit to exceed or not to reach its quota. Instances have occurred where it was more remunerative for a very inefficient unit to close down and to rely upon the compensation it received from the pool. Clearly, if this were to go on indefinitely and over any considerable area, the total financial and economic effect would be most unsatisfactory.

32. The rebate system has also been extensively used. Here distributors are required to purchase from the combine only, and to undertake not to purchase similar goods from competitors outside the combine, in consideration of a special periodical rebate.

This is the principle employed by shipping conferences in paying rebates to shippers. Having regard to the special conditions obtaining in the shipping trade and the need for regular services, the rebate system has been reasonably justified.

33. It will be seen from this brief review that the members of the accountancy profession have responsible duties to perform, and in each of these methods of amalgamation must combine professional wisdom with strict impartiality.

Mr. A. E. Cutforth, C.B.E., has written an admirable book entitled "Methods of Amalgamation" which deals in further detail with the general accounting questions I have outlined in this paragraph.

INTERNATIONAL AGREEMENTS

34. A short epitome of international agreements may appropriately be set out here.

(a) *International Steel Agreement* (E.I.A.).

35. The report of the Experts of the League of Nations appears somewhat inconclusive—it is stated that the difficulties were great—but the object of the agreement was to regulate production and indirectly to check excessive fluctuations in prices.

(b) *The Franco-German Potash Agreement*.

36. The purpose is to restrict production of German potash to efficient works. The French organisation aims at popularising the use of potash as a fertiliser, and the selling of potash products. The total

German output satisfies 3/4ths and the combined French and German output 19/20ths of world requirements.

The total supply and the total demand are divided between the members on a quota basis. It is declared that the agreements have been beneficial in—

- (a) stabilising prices for the farmer ;
- (b) keeping prices low to increase demand.

The production for 1926-28 was :—

			<i>Germany</i>	<i>France</i>	<i>Total</i>
			<i>Tons</i>	<i>Tons</i>	<i>Tons</i>
1926	..	..	1,260,047	352,034	1,612,081
1927	..	..	1,518,724	333,273	1,851,997
1928	..	..	1,690,469	427,997	2,118,466

- (c) a common propaganda policy ;
- (d) united scientific study to extend the use of potash under varying conditions.

37. The above views, extracted from a League of Nations publication, I submitted to one who has had a long experience in potash. His reply seems sufficiently important to merit (in part) insertion at this point.

“ Before the war Germany possessed in Stassfurt and Alsace the only known deposits of potash in the world. I remember in my early days, potash was mined in Germany in the same way as coal in this country, by the individual owners of the various potash mines. The output was sold in open competition at prices up to £3 10s., according to the various qualities of sulphate, muriate or kainit, f.o.b. German ports.

“ As the result of the Franco-German war in 1870 the province of Alsace passed to Germany, and in Alsace were discovered immense deposits of potash. Germany practically said to herself—Why should we, owning the only known deposit in the world, give away the benefit of this valuable asset ? The result was the formation of the great and powerful Stassfurt Syndicate, embracing in its folds every potash mine in Germany and Alsace, and the price was fixed at £8 10s. f.o.b. German ports, for all the buyers of the world. The Syndicate backed by

the Deutsche Bank had agents in every country of the world, and enjoyed a world monopoly.

"On the termination of the war, the province of Alsace reverted to France ; the French Government immediately appointed a potash controller and entered the world's markets with Alsatian potash. The result was severe competition with Germany, accompanied by a cutting of prices until they reached a low level. This lasted for some considerable time, until an agreement was made between the German and Alsatian interests, followed by a gradual rise in prices.

"Then potash deposits were discovered in Spain and Poland, and now potash production is being developed from the waters of the Dead Sea.

"The U.S.A. never liked the monopoly and spent immense sums of money trying to find potash in various parts of the world without success. During the war she developed potash from her Salt Lake deposits, and is still doing so, but production is expensive as compared with the simple mining operations in Germany and Alsace."

(c) *Artificial Silk.*

38. Leading firms in Europe have combined to form the Bureau International pour la standardisation des fibres artificielles (BISFA) for the purpose of investigating the economic position and international markets and to establish the standardisation and uniformity of products. It is urged that there is no other solution than to form a kind of cartel.

The Economic Committee of the League of Nations, in the Review prepared by experts (1930), express the broad view that only undertakings which are capable of producing 6,000 kilogrammes (13,227.6 lbs.) per day, which necessitates a capital of £750,000 or more, "are able to meet the financial requirements of this delicate industry."

The undermentioned figures relating to three artificial silk companies, which were floated within the last eight years, indicate the reason of failure :—

				<i>Estimated</i>	<i>Estimated</i>	<i>Capital</i>
				<i>output</i>	<i>Profits</i>	
				<i>per day</i>		
				Lbs.	£	£
Company: A	..	..	4,585	120,000	400,000	
„ B	..	..	4,800	100,000	385,000	
„ C	..	..	3,300	90,000	365,000	

Needless to say, none of these figures was realised, and many of these newer companies have ceased to exist, or, at any rate, ceased to produce.

39. About 84 per cent. of artificial silk is produced by the Viscose process, 10 per cent. by the Cupro-ammonium process, and 6 per cent. by the Acetate process. The output has apparently increased enormously during the last twenty-five years, from approximately 6,000 to over 200,000 tons per annum.

The fact that the prices are about half those of pre-war days indicates the rapid strides made in scientific manufacture.

(d) *The European Linoleum Trust.*

40. The selling prices in foreign countries are fixed by agreement with the English Linoleum Industry (British Association). Since the creation of the cartel in 1910, prices have kept fairly low, reductions occurring in 1927. Owing to the rise in the cost of the principal raw materials—linseed oil and cork—prices of German manufacturers were raised in 1929. It is understood that one large firm in this country remains outside the agreement.

(e) *Electric Lamp Industry.*

41. The Filament Trust (1911) pooled the patents of three of the largest German firms. In 1919 all the larger producers in this country amalgamated to form the E.L. Manufacturers' Association. The British General Electric is the largest firm, while in 1928, Metropolitan Vickers, British Thompson-Houston and Edison Swan combined under the name of Associated British Industries Ltd. There is also an intermediate company—the Phoebus Co. at Geneva—which acts in the exchange of methods and in respect of patents. The objects are the exchange of inventions and experiments, the regulation of

prices, limitation of sales, and allocation of sales areas, which are determined on a basis of standard years.

A CRITICAL REVIEW OF THE POLICY OF COMBINES

Principal Criteria.

42. I suggest the following eight criteria as a guide for reviewing the general effect of capitalist combinations in industry :—

- (a) Stability of prices and maintenance of quality of goods to the consumer.
- (b) The development and application of scientific research and technical improvements for the continual reduction of costs.
- (c) The proper organisation of management and control without undue centralisation.
- (d) The maintenance or increase of profits to shareholders.
- (e) That the capital is in harmony with earning capacity.
- (f) Generous allowance for depreciation and obsolescence (the rate of obsolescence tends to increase, owing to inventions and new methods).
- (g) Adequate provision of liquid reserves.
- (h) The maintenance of good relations with labour and an improvement in labour conditions.

Difficulties.

43. Mr. E. J. H. Lemon, of the London, Midland and Scottish Railway, in a recent paper, speaks of the great difficulties encountered in the effort to reorganise the system on a modern basis. Probably in no system did overlapping occur more patently than in the railway systems. Traditions of nearly a century had to be uprooted, with the inevitable creation of dissatisfaction. He said :—

“ The whole was a mass of overlapping areas and functions, of different practices and methods, of different traditions and upbringing. What had to be done was to break down century-old *esprit de corps*, at the same time replacing it with new interests and service to a new company.”

44. Looking at the problem from a different angle, Dr. Coates,

with great insight, writing in 1928 of the innumerable difficulties which had to be faced, said :—

“ Even in the most favourable circumstances, the benefit of concentration in large units comes but slowly. Many pitfalls have to be avoided. Over-capitalisation is an ever-present danger, stimulated by the necessity of securing the assent of exchanging shareholders through an increase in the nominal value of the capital held. There is the inclination to attach too high a value to real assets, based on the cost of their reproduction, and on forgetfulness of the fact that once liquid capital has become fixed in industrial plant its worth is governed almost entirely by its earning power. Even that earning power may be turned into capital values on too high a basis by the use of an excessive multiplier, without sufficient allowance for the future provision of internal reserves. In any case heavy initial expenses must first be faced. . . . Compensation cannot be avoided, not only to displaced workers, but to displaced officials, directors and others. Capital losses will also have to be written off as redundant plants are closed, and as manufacturing operations are gradually concentrated in the most efficient and best situated works.”

Administrative Efficiency.

45. The benefits to be derived from scientific research are nowhere more clearly discernible than in the reports of the extensive investigations carried out on the L.M.S. Railway system. To mention a few only of the successes which have followed the scrutiny :—

- (a) Stock items have been reduced by 50,000 items by the elimination of obsolete types of materials.
- (b) Items purchased under contract have been reduced from approximately 6,800 (at the time of the amalgamation) to 4,400.
- (c) Purchases in bulk of stores and materials have been effected upon more favourable terms. Smaller stocks are found to be necessary and economies in handling have been effected.

46. Comparative costing revealed the increased cost of repairing locomotive boilers in England as compared with Scotland, and

research provided the reason, namely—"The water in Scotland is so much better." This discovery, of course, led to the installation of water-softening plants in England. A system of progressive repairs to locomotives has reduced the time of laying-up for repairs, of one type alone, from thirty-eight days in 1925, to six days in 1930.

Obviously the consumption of coal came under review, as the expenditure under this heading approximated five millions sterling per annum.

47. In collaboration with the North Eastern Railway, experiments made in the wind tunnel of the National Physical Laboratory gave the following interesting results:—

(a) In a ten-coach train 29 per cent. of the wind resistance is accounted for by the engine and tender ;

8½ per cent. by the first coach ;

6½ per cent. by each of the next 8 coaches ;

9½ per cent. by the 10th coach.

(b) At 60 miles per hour, without any head wind, about 400 h.p. is absorbed in overcoming the air resistance of such a train.

48. Mr. E. J. H. Lemon, the Vice-President, from whose paper I have quoted, bears testimony to the results which have followed the introduction of "budgetary control." The effect of fixing limits of expenditure undoubtedly has great influence upon the minds of responsible officials.

Whatever we may think of past achievements, we are bound to admit that full systematic control becomes more realisable in the case of a large combine, where the cumulative effect of economies spread over a wide area yields to scientific management a richer reward.
The Public Attitude.

49. We must clearly face the inherent prejudice of the public against combinations. Suspicion is less easily roused than it was some years ago, as I do not think there has been any glaring evidence of rampant exploitation of the consumer. But the danger of public suspicion, whether based on fact or on rumour, lurks in the background. A large part of the Report of the Committee on Trusts in 1919 was devoted to the possibility of abuses tending to the detriment of the public, arising from monopolies, trusts and combines. The Com-

mittee found that no definite evidence was brought before them that excessive charges had been made by combinations. It had, however, been made plain to the Committee that distributors and producers did not, in all cases, show the confidence which had been expressed by the witnesses representing combines.

50. Apart from the better-known combines, in the shares of which the public has a substantial interest, there are in Great Britain a large number of combinations or associations exercising considerable influence, of which the public is scarcely aware. Many of them had dealings with the Ministry of Munitions during the war, and on the whole it was found there was little ground for complaint.

51. The Committee on Trusts of 1919 made a recommendation that the Board of Trade should watch the development of combines and should refer any complaints received to a special tribunal for investigation. The recommendation has never been carried out and apparently subsequent circumstances rendered it unnecessary. Modifications of the proposal, however, may be mentioned. Under the Profiteering Act of 1919, a Committee made certain investigations, but its operations came to an end in 1921. A Food Council has more recently been set up by the Board of Trade, which is authorised, after due inquiries, to give publicity to its opinion as to the prices of certain articles of retail food consumption. Thus there is practically no legal protection, but publicity by the Food Council and generally in the Press of any attempt by combinations to raise prices unduly, is an effective and more desirable check than direct means.

Management and Finance.

52. The organisation of a network of holding and subsidiary companies has become complex and extensive. It may be questioned, therefore, whether a single human mind can readily grasp the implication of a whole scheme in its entirety. Certainly such minds are rare. This aspect of management and control seems to suggest that indefinite expansion must prove unsatisfactory and may lead, failing the most expert management, to serious consequences. It may be reiterated that after a certain size has been reached, additional economies cannot be effected or a reduction in the standard of overhead charges secured.

53. There remains to be mentioned that group of financial considerations relating to capital, profits and reserves.

I suggest that one of the principal difficulties is the necessary inclusion in the combine of weaker units of production. These are included because even though under competition they might have closed down, a long period of weak production and weak selling is bad for the industry, and may also have repercussions on the consumer in the long run. Further, the deficient earning power of the capital representing weaker units has to be made good.

The experience of older combines shows that deficient management and over-capitalisation have been the two vulnerable points.

54. The earlier criticisms of combines were mostly from the consumer's point of view, but I suggest that the emphasis of any possible anxiety in regard to combines may shift from the consumer to the large body of shareholders interested in these giant undertakings.

COMBINATIONS AND THE GREAT DEPRESSION

55. The policy of combines being to give greater stability in prices and in profits, it is relevant to consider that policy in relation to the great depression through which the world has passed. If it were ever considered that powerful combinations could offer a barrage of resistance to an incoming tide of economic depression, experience has definitely disproved that hypothesis. Sir Arthur Salter has even indicated that the large scale organisation of modern business has possibly been an aggravating factor. A combine is inevitably less flexible to certain changes in demand. It is easy for a large scale organisation, anticipating a rise in prices, to continue production after it has ceased to be profitable. The smaller undertaking more quickly responds to a falling-off in demand.

56. Further, the combines have been peculiarly subject to rigidity in wage rates. Public requirements have been intensified for semi-luxury goods, the demand for which is capricious and very elastic, and subject to rapid changes of fashion and technical improvements. These factors have accentuated the difficulties of combines in times of depression.

57. It can be represented with reason, of course, that the depression having been so overwhelming, the more newly formed combines were working under totally abnormal conditions, and their efficacy and profit-earning capacity were not therefore subjected to a fair test.

BIG BUSINESS AND SMALL BUSINESS

58. To illustrate the growth of combines, I append a table (Table II) giving a short list of companies which represent combinations, showing the capital at successive periods since 1900. In one or two cases I have indicated the previous capital of some of the companies which were eventually taken over by the holding company. The list is not intended to be a complete statement in detail, but its main characteristics are illuminating.

59. The growth of "big business" is readily accepted, but the expansion and strength of "small business" in this country may easily be overlooked. Even in these days the Englishman is not persuaded that individualism in relation to business is effete and redundant. We cannot lightly disregard the spirit of independence and self-reliance which the control of smaller companies and firms implies.

60. I append a statement extracted from the annual Board of Trade Report on Companies for the year 1931 (Table III). The average paid-up capital of companies under different headings has been calculated. The private company first came into being in 1908. Private companies generally are inevitably of smaller capital than public companies. In spite of the effect of private companies on the joint figures of both classes, the average capital of all companies on the register has steadily risen since 1910. Similarly the average capital of public companies since 1926 has gone up by a considerable amount, and yet there were over 98,000 private companies on the register for the year 1931 as against 15,000 public companies.

61. The effect of these figures is that 14 per cent. of all companies were public companies and controlled 71 per cent. of the aggregate capital invested in companies, while 86 per cent. of the number of all companies were private companies and controlled 29 per cent. of

the aggregate capital (Table IV). The 14 per cent. of public companies does not disclose completely the extent of combination, since, for example, a holding company and, say, its five subsidiaries would count as six companies on the table. I anticipate that the percentage of the number of companies controlling 71 per cent. of the capital is considerably lower.

62. These figures lead to two conclusions :—

(1) The growth of concentration and combines in public companies.

(2) The persistence and increase in number of private companies.

As private companies are mostly in the hands, and for the benefit, of a comparatively few individuals, I take those figures to be an unquestioned indication of the vitality and tenacity of individual enterprise. Further, there is a large number of public companies of smaller dimensions which, in spite of the difficult time through which we have passed, have maintained their position in a comparatively satisfactory manner.

63. In regard to our own profession, I would quote an editorial note from the *Incorporated Accountants' Journal* of November 1929 :—

“ ‘ Rationalisation ’ is popularly supposed to be the remedy for all industrial troubles. . . . These mergers have far-reaching effects and often bring in their train many unfortunate consequences, including the elimination of independent business men who have to choose between accepting a salaried position and being forced out of business altogether. The accountancy profession also suffers from these mergers. When one large company absorbs a number of separate entities, what were probably a dozen audits by different firms of accountants become one audit by a single firm. The loss falls mainly on the small practitioner, but it must be remembered that there is also a loss in the total volume of professional business and not merely a transfer of business from one firm to another.”

64. It is not possible to obtain precisely the number of combines operating in this country and elsewhere, but the following figures are interesting :—

REPORT OF COMMITTEE ON TRUSTS, 1919

<i>Great Britain—</i>	<i>Number</i>
Iron and Steel Industry	35
Chemicals (controlling production almost wholly) ..	2
Electric Industries	1
Encountered by the Ministry of Munitions ..	93
Soap, Tobacco, Wallpapers, Cement, Textiles (securing effective control of output and prices).	Number not given
<i>U.S.A.—</i>	
American Meat Trust	5

LEAGUE OF NATIONS: REVIEW OF . . . INDUSTRIAL AGREEMENTS,
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65. I attach a table (Table V) showing the average financial result achieved by eight combines in 1931, compared with the result obtained by 2,017 other companies. The figures are substantially in favour of the large number of smaller companies. The arguments for rationalisation are convincing ; the experience of rationalisation is sometimes disappointing.

PUBLIC UTILITIES

66. An interesting form of enterprise in Great Britain is the Public Utility Trust, constituted by *ad hoc* Act of Parliament. The trusts are in some cases the combination of a number of previously constituted undertakings. They are financed by stock bearing fixed rates of interest. They are controlled by Boards nominated by various interests, and are free from political influence or interference. Some of these trusts have been conspicuously successful in regard to the services they have provided, and the regular way in which they have earned their interest. I would mention particularly the Port of London Authority, the Mersey Docks and Harbour Board, and the more recently constituted British Broadcasting Corporation and the Central Electricity Board.

67. Having dealt at some length with general principles, we may now make, by way of concrete illustration, a detailed review of combination or merger operations. For this purpose I have selected

for investigation as representing commerce : banking, insurance and building society amalgamations ; and as representing industry : chemicals.

BANKING

British Banking Policy.

68. The relationship between industry and banking is so close that a study of capital combinations would be incomplete without a reference to bank amalgamations.

69. At a meeting called to sanction the Midland Amalgamation in 1918, the late Sir Edward Holden—a recognised leader of the policy, which has led to the absorption into his own bank of no less than thirty-three units—summarised the benefits to be expected in the following six points :—

1. “ The first benefit accruing to the large banks from these big amalgamations is a large increase in their capital, and a large increase in their resources ; but if you are going to stop amalgamations, they will not be able to increase their capital any more on that line.”

2. “ Big banks will help to increase our commercial exports abroad, and to off-set an unfavourable trade balance after the war.”

3. “ Every development of amalgamation has rendered the banks more stable, and our recent immunity from the distresses consequent on bank failures has been due to the strengthening of the banks by amalgamation.”

4. “ But for the amalgamations the banks could not possibly have given adequate assistance to our enormously increased trade.”

5. “ We have not had a single instance in which the accommodation given by a bank taken over by us has not been much greater after amalgamation than it was before the bank was taken over.”

6. “ The deposits of this country can be more effectively lent if they are concentrated than if they are scattered.”

70. The paid-up capital and reserves of joint stock and private

banks in England and Wales, including the Bank of England, covering a period of nearly a century, make interesting reading :—

<i>Year</i>	<i>No. of Banks</i>	<i>Capital £</i>	<i>Reserves £</i>	<i>Deposits £</i>
1836	—	10,000,000 (estimated)	—	—
1884	109	52,505,000	24,374,000	300,139,000
1914	43	49,405,000	27,093,000	783,553,000
1930	13	91,510,000	66,990,000	1,915,203,000

In September 1932 the paid-up capital of the ten London clearing banks was £74,311,096 and the reserve funds £51,010,000. Of this capital the Big Five held £64,715,000 and of the reserve £44,750,000.

The net profits of all banks (as given by Sykes) as a *percentage of total working resources* was 1.88 (1874), .94 (1914), .79 (1920), .57 (1923). Other authorities, taking the percentage on capital plus reserves, contend that an opposite tendency is shown.

71. The percentage of expenses to total working resources of the Union Bank of London rose from .53 in 1879 to .93 in 1913. Amalgamations took place in 1891 and 1902-03 and were followed by increases in expenses. The percentage increase in the case of the London and Westminster Bank was .34 in 1880 with eight branches, .46 in 1908 with thirty-seven branches, 1.26 in 1913. The amalgamation with the London and County Bank took place in 1909. The figures appear to demonstrate a natural increase in the expenses as additional branches are opened, and their business expands. Allowance must, of course, be made for the gigantic growth in the number of small accounts, obviously operated at a higher ratio of expense.

72. On 2nd August 1923, the late Dr. Leaf referred to a comment by the *Manchester Guardian* on the opening of new branches :—

“ The banks themselves are beginning to see that a lust for record figures may be gratified at too great a cost.” Dr. Leaf asserted that the only persons entitled to complain were the shareholders, whose profits were devoted in some measure to the opening of fresh branches which could not pay their way for a long time. Before the war, he said, a new branch commenced to pay after it had been opened

three to five years, but since the war the period had been about doubled owing to the rise in overhead expenses on the one hand and the severe cutting of profits on the other.

In 1825, 554 private banks operated 681 branches.

In 1924, 2 private banks operated 2 offices ;

13 joint stock banks possessed 8,081 branches. .

In 1930, 13 joint stock banks possessed 9,972 branches.

In the first named year (1825) there was one banking office to every 18,739 of the population ; in 1924, one to every 4,777. In that period the population had increased three times over while the bank offices had increased twelve times over.

73. On the question of stability it may be recalled that in 1825-26, sixty-three private banks outside London failed, in 1840 twenty-four, in 1841 twenty-six. There have been no failures of importance since 1890, notwithstanding the 1914 and the present crises. On the score of safety, therefore, the superiority of the present system is evident.

In 1890 the Baring Crisis occurred. The Governor of the Bank of England took immediate steps to open a guarantee fund in which the leading joint stock banks were asked to participate. The response was both full and speedy. Undoubtedly much turned on the capacity as well as the willingness of the joint stock banks to subscribe. This was the first occasion on which the large joint stock banks took concerted action, and it was undoubtedly due to the policy of amalgamation that they were strong enough to do so. Further illustration is found in the case of the Yorkshire Penny Bank (now owned by the Big Five), in the war period mobilisation of securities, in the control of exchange rates, and in the formation of the Agricultural Mortgage Corporation, the capital of which was subscribed by the banks.

74. The amalgamations which have taken place between 1825 and 1924, totalling 552, are made up as follows :—

Private with private	..	..	..	..	103
Joint stock with joint stock	..	..	..	..	165
Private by joint stock	..	..	..	..	282
Joint stock by private	..	..	..	..	2

Foreign Banks.

75. *The Times* pointed out on 4th May 1918 that the whole industrial, financial, commercial and shipping forces of Germany were being brought together in limited liability companies, and stated that the object of the organisation was that Germany should present an absolutely united front. Our bankers were also aware of the steps being taken by German banks, three of whom, the Deutsche, Dresdner and Disconto, had increased their capitals by 40 per cent. to a total of $52\frac{1}{2}$ millions sterling and their reserves by 60 per cent. to a total of $28\frac{1}{2}$ millions sterling by absorptions since 1914. More recent amalgamations have taken place, at least two in 1929 and one in 1932.

76. The tendency to amalgamation or working agreements is also visible in French banking, though to a much less degree, and one important French bank has entered into close relationship with several institutions in the United States, besides linking up with a South American Bank, on the Board of which it has placed a representative.

77. Another interesting development is an alliance (without amalgamation) between two large South American banks. The allied banks have in turn entered into a working agreement as regards South American business with one of our clearing banks, in furtherance of which the latter has established a subsidiary company with a capital of a quarter of a million in combination with the newly-formed British Trade Corporation.

78. In Canada too, the Bank of Montreal has taken over the Bank of British North America ; and the Royal Bank absorbed the Quebec Bank and the Union Bank of Canada. In Australia the National Bank and the Colonial Bank entered into an agreement to amalgamate.

Observations on Bank Amalgamations.

79. The Treasury Committee on Bank Amalgamations of 1918 obviously appreciated that there was a risk both of reduced competition or of monopoly and of the creation of a " Money Trust." Indeed, they go so far as to state that " on a careful review of all the above considerations, we are forced to the conclusion that the

possible dangers resulting from further large amalgamations are material enough to outweigh the argument against Government interference." It will be remembered that the Association of British Chambers of Commerce has expressed similar views.

80. It is, however, only just to recall that competition between the great banks is to-day extremely keen. If the banks consider themselves entitled to see the audited balance sheets of customers, professional accountants, at any rate, have no cause for complaint, whatever they may have to say in respect of those extraneous "side-lines" which the banks are cultivating so assiduously in modern times.

81. I referred at an earlier stage to the intimate connection between commerce and banking. A comparison between the figures of the London Clearing Banks for September 1931 and September 1932 is illuminating. Deposits have increased in the twelve months by over 153 millions sterling, and investments by 79 millions, while advances to customers have decreased by over 108 millions.

Summary.

82. The available statistics indicate that while expenses have generally increased, profits have decreased, but facilities to the public have undoubtedly been extended. One writer suggests that the increased charges are finally borne by individual customers in the shape of reduced deposit rates and increased loan rates, and urges that if further large amalgamations occur "charges will again be increased."

Undoubtedly liquidity, stability and safety have been secured by amalgamation—a remarkable achievement for these difficult times.

INSURANCE

83. The chief and more recent amalgamations or absorptions in the insurance world are indicated in the following list :—

Commercial Union :	Palatine (1900)
	Hand-in-Hand (1905)
	Union (1907)
	Ocean (1910)

Commercial Union	National of Great Britain (1917)
(<i>continued</i>) :	Edinburgh Life (1919)
	British General (1923)
	West of Scotland (1923)
Royal Exchange :	National Provincial (1909)
	Car & General (1917)
	Local Government Guarantee (1918)
	State (1924)
	Motor Union (1928)
Northern :	Royal Scottish (1914)
	White Cross (1914)
	Provident Accident (1917)
	World Marine (1920)
	London & Scottish (1923)
Royal :	British & Foreign (1909)
	Warden (1913)
	Legal (1916)
	Liverpool, London & Globe (1919)
Yorkshire :	United Legal (1909)
	London & Provincial Maritime (1913)
	Premier (1913)
	Guarantee Society (1914)
	Commercial of Ireland (1922)
London Assurance :	British Law (1917)
	Vulcan Boiler (1920)
	Guildhall (1931)
London & Lancashire :	Standard Marine (1907)
	Australian Alliance (1909)
	Marine (1917)
	Law Union & Rock (1919)
	British Fire (1923)
	Colonial Mutual (1927)
Phoenix :	Law Life (1909)
	Union Marine (1911)
	Northern Maritime (1917)
	London Guarantee (1922)

84. The capitals of the twelve companies with the largest share capital, in 1931, are shown as follows :—

					<i>Share Capital</i>	
					<i>Subscribed</i>	<i>Paid-up</i>
					£	£
1.	Scottish Union & National	..			5,650,820	300,000
2.	Royal	..	..	..	5,599,930	2,799,965
3.	Alliance	..	..	..	5,450,000	1,000,000
4.	Northern	..	..	..	4,519,110	904,161
5.	North British	..	..	..	4,500,000	2,437,500
6.	Phoenix	..	..	..	3,792,795	1,005,000
7.	London & Lancashire	..	..		3,639,310	1,455,724
8.	Commercial Union	..	..		3,540,000	3,540,000
9.	Eagle Star & Brit. Dominions	..			2,998,425	1,092,896
10.	Sun Insurance Office	..	..		2,400,000	600,000
11.	Atlas	..	..	..	2,200,000	550,000
12.	Guardian	..	..	..	2,059,971	1,024,578
					<hr/>	<hr/>
					£46,350,361	£16,709,824
					<hr/>	<hr/>

85. It will be observed that the only company in the above list whose subscribed capital is fully paid is the Commercial Union, and that in respect of the remaining eleven companies no less than £29,640,537 is represented by uncalled capital—a substantial reserve to the companies, but also a remarkably heavy, if ignored, liability of the shareholders.

It will further be observed that no scientific relationship between paid-up and subscribed capital is apparent : on the twelve companies it works out at 36 per cent.

86. While economies have certainly been effected by many offices, the available figures suggest a slight increase in working expenses. A material reduction in premium rates during the past few years has been of benefit to the insuring public.

87. The estimated loss of capital to shareholders in each of the last ten years has been stated to be :—

					£
1921	..	..	..	..	1,633,147
1922	..	..	..	..	4,719,076
1923	..	..	..	..	749,437
1924	..	..	..	..	153,000
1925	..	..	..	..	375,509
1926	..	..	..	..	1,586,019
1927	..	..	..	..	47,873
1928	..	..	..	..	250
1929	..	..	..	..	258,972
1930	..	..	..	..	480,300
1931	..	..	..	..	22,000
					<hr/>
					£10,025,583
					<hr/>

Of this total £1,955,091 appears to have been lost on transfers to other companies, and £8,070,492 under liquidations.

88. The bases upon which ten amalgamations have been effected during the last few years, which are set out below, indicate that the absorbing companies are prepared to agree to generous terms, being no doubt largely influenced by the magnitude of the premium income to be obtained (see page 416).

Fire Offices Committee.

89. No review of the subject would be adequate without a reference to the operation of the Fire Offices Committee. Other controlling committees, performing similar functions, act in respect of Accident and Life Offices.

90. The Fire Offices' Committee has been in existence more or less in its present form for some seventy-five years. Its membership comprises some 104 offices operating in the home country. Because of this membership such offices are known as and generally styled Tariff Offices. The work of the Fire Offices' Committee consists of :—

- (a) Collecting statistics relating to the aggregate experience (i.e. premiums collected and losses paid) of all the offices forming

Date	Name	Date Formed	Subscribed Capital	Paid-up Capital	Transferred to	Purchase Consideration	Price per Share	Market Price of Shares prior to the Fusion
1922	British Equitable London Guarantee & Accident	1854 1869	30,000 at £10, 23s. paid 5,000 Prefs., £5 fully paid 44,823 Prefs., £1 fully paid 125,000 Ords., £1 fully paid	£ 34,500 194,823	State Phoenix	£ 112,500 2,444,823	* £ s d 3 15 0 19 0 0 (ordinary)	£ s d 3 10 0 10 5 0
1923	British Fire	1908	492,000 £1 each, 4s. paid 8,000 £1 each, fully paid	106,400	London & Lancs.	292,600	Partly paid 11s. Fully paid 55s.	10 0
1924	London & Scottish State Assurance West of Scotland	1862 1891 1886	120,000 £5, £1 paid 100,000, £8, £1 paid 50,000, £5, £1 paid	120,000 100,000 50,000	Northern Royal Exchange Commercial Union	840,000 1,100,000 462,500	7 0 0 11 0 0 9 5 0	4 10 0 8 10 0 9 10 0 (on rumour of amalgamation)
1925 1926 1927	Hibernian Fire & General British General Motor Union	1908 1904 1906	200,000, £1, 4s. paid 700,000, £1, 5s. paid 174,543 5½% Pref., £1 fully paid 200,000 Ords., £1 fully paid	40,000 175,000 374,543	Guardian Commercial Union Royal Exchange	100,000 1,942,500 Not available but over £1,500,000	10 0 2 15 6 9 15 0	6 0 1 17 6 7 15 0 (only shares held by public)
1931	Guildhall	1919	249,998 £1 each, 10s. paid 2 £1 each, 20s. paid	125,001	London Assurance	606,250	Equals £4 17 0 per £1 paid up	—

its membership in respect of any class or classes of risk to be reviewed.

(b) On the result of the experience mentioned in (a), compiling rates, conditions and warranties, &c., for each class of risk. The result is seen in the issue of what is termed a "tariff" such as "shipbuilders' tariff," "metal workers' tariff." Similarly old tariffs may from time to time come under review and be re-issued in different forms, and probably ratings increased. To-day there are close upon 100 different tariffs (fire) applicable to different industries.

(c) Framing rules regulating re-insurance business, arbitrations, commissions payable to agents and general rules applicable to all tariffs.

(d) Framing forms of policy and general conditions of insurance.

91. The Committee meet regularly and the procedure is that :—

(a) The chairman must be entirely unconnected with any fire insurance company (the chairman usually belongs to the legal profession and he has no vote).

(b) Each membership office has a representative present and they as a body decide and vote on all matters.

92. The membership of the Fire Offices' Committee or Accident Offices' Association is not of itself a guarantee of the financial stability of a company. Some thirty years ago, I believe £15,000 to £20,000 paid-up capital invested in safe and realisable securities was considered sufficient evidence of stability, and under the Assurance Companies Act, 1909, £20,000 deposit with the Government became necessary before a new company could operate. To-day all reputable companies, whether tariff or non-tariff, demonstrate a much higher standard.

93. Membership of the Fire Offices' Committee or Accident Offices' Association merely implies agreement to stand firmly to the rates and conditions issued from time to time by the two Tariff Associations. In commercial language, it is a price maintenance scheme. There can therefore be no reflection in general upon the companies who remain outside the Tariff Associations, which have become known as Non-Tariff Offices. In Great Britain there are some ten

non-tariff offices operating, and generally speaking they are comparable in strength to any tariff office. There are also some thirty more companies outside the tariff, but these are mostly mutual or denominational and were formed at different times to combat the increasing tariff rates.

94. The real key to any insurance company's financial strength is not the fact that it is tariff or non-tariff, but the ratio of—

Funds to Premium Income ;

Assets to Liabilities.

The larger the premium income the greater the liability, and therefore premium income in itself is no guide.

BUILDING SOCIETIES

95. An aggregate balance sheet of all societies for the year 1931, contained in the report of the Chief Registrar of Building Societies dated 6th May 1932, indicates the important position which building societies have attained as financial institutions.

<i>Liabilities</i>		<i>£</i>	<i>Assets</i>		<i>£</i>
Capital .. ..	..	302,870,608	Mortgages ..	..	316,232,546
Deposits .. ..	..	44,539,795	Investments and		
Loans .. ..	..	5,938,639	other Assets ..	..	54,932,414
Undivided Profits		17,815,918			
		<u>£371,164,960</u>			<u>£371,164,960</u>

96. The rapidity of modern growth is indicated by the fact that during the ten years ended 1930, the additional capital subscribed was £167,637,786, an average of £16,763,778 per annum.

97. The security in the mortgages is very great. Apart from the fact that the value of the property under mortgage, at the lowest estimate, must be in the region of 400 millions sterling, the spread of the risk furnishes a super-gilt-edged security, enhanced as it is by the operation of the reducing tables. Thus the £316 millions outstanding on mortgage are classified as follows :—

(a) Mortgages of £1,000 and under	£259 millions
(b) Mortgages between £1,000 and £5,000 ..	47 ..
(c) Mortgages over £5,000	10 ..

98. Two or more societies may unite and become one society, with or without any dissolution or division of funds, or one society may transfer its engagements to another, subject to three-fourths of the members of each society present at general meetings assenting thereto, and to the concurrence in writing of the holders of not less than two-thirds of the whole number of shares of each society (Building Societies Act, 1874, Section 33; Building Societies Act, 1894, Section 19).

99. Amalgamations are somewhat rare. The latest (1931) was that of three societies in the Midlands, now united as the Birmingham Incorporated Building Society. Special difficulties had to be overcome in this particular amalgamation, owing to one of the societies being really a land society. The result of the amalgamation has been a reduction of working expenses, while the profits have been fully maintained.

100. The amalgamation of the Halifax Permanent Building Society (largest in the world) and the Halifax Equitable Building Society was completed on the 1st February 1928.

The Halifax Permanent Building Society was founded in the year 1853, and at the date of the amalgamation its assets were £32,936,509. The Halifax Equitable Building Society was founded in 1871, and the assets were £14,044,972, the combined assets of the two societies being £46,981,481. The union was a perfectly natural one and took place under conditions which were peculiarly favourable, because the two societies had developed side by side in the same district for a period of more than fifty years. The results of the amalgamation very soon proved to be wholly beneficial to the members, and afforded opportunities for effecting considerable economies in administration expenses, advertising, branch premises and other directions.

Striking evidence of the success attending the fusion of the two businesses is shown by the fact that the combined assets of the societies on the 1st February 1928, namely, £46,981,000 rapidly increased year by year and now amount to over £85,000,000.

101. The larger societies have the advantage of spreading their risks in respect of mortgage assets, but in this matter reliance must be placed upon surveyors' valuations. Where reasonable care and

skill are not exercised by a surveyor, he has been held liable in damages.

102. As to relative working expenses, a calculation made by Mr. James Brace, B.Sc., LL.B., gives the following results :—

<i>Average Value of Assets</i>					<i>Simple Average of Costs of Administra- tion per £100 of Average Assets</i>
Up to £200,000	..	..	..	..	·76
£200,000 to £400,000	..	..	..	..	·68
£400,000 ,, £600,000	..	..	..	..	·62
£600,000 ,, £800,000	..	..	..	..	·64
£1,000,000 ,, £2,000,000	..	..	..	..	·55
£2,000,000 ,, £3,000,000	..	..	..	..	·43
£3,000,000 ,, £4,000,000	..	..	..	..	·61
£5,000,000 ,, £10,000,000	..	..	..	..	·69
£10,000,000 ,, £20,000,000	..	..	..	..	·65
£50,000,000 ,, £60,000,000	..	..	..	..	·56

The investigation was made on a somewhat limited basis, but it is nevertheless of value, pending a promised report of a more exhaustive nature.

103. The individual share capital and mortgages of societies with over ten millions of capital was, in 1930, as follows :—

				<i>Capital</i> £	<i>Mortgages</i> £
Halifax	..	..	..	58,649,614	52,902,784
Abbey Road	..	..	..	27,505,876	27,944,275
Woolwich Equitable	..	..	..	14,540,177	15,066,864
National	..	..	..	11,442,113	11,791,693
Co-operative	..	..	..	10,723,669	11,306,607

104. Generally it may be conceded that the larger societies gain very materially in :—

- (a) Obtaining properly qualified officials, a point of paramount importance.
- (b) Economy in establishment expenses.
- (c) A wider appeal for funds.

- (d) The avoidance of too great a dependence upon local influences.
- (e) The spreading of risks, and the consequent operation of the law of average.

CHEMICALS

105. Taking one of the more recent English mergers (Imperial Chemical Industries Ltd.), we have a period of six completed years upon which to endeavour to base a judgment.

In our consideration of the figures we must keep well in mind the difficulties of the period covered—a period of extraordinary depression, especially in the last three years. According to the Index Number of Profit prepared by Sir Josiah Stamp (*The Times*, 20th July 1932), the general return upon capital as a whole fell from 106.5 in 1927 to 90.0 in 1931, and the return for risk-bearing capital (ordinary shares, &c.) from 111.4 in 1927 to 73.3 in 1931. The index relates to aggregate profits, and is based on a figure of 100 for 1924.

106. The promoters of Imperial Chemical Industries in the "Invitation to accept shares" of 15th December 1926, expressed the view of the chairmen of the four participating companies that after making due provision for reserves the future income of the new company should exceed £4,000,000. The actual profits of each year after deducting reserves, both general and obsolescence, set aside out of profits, were :—

						£
1927	..	..	..	..	..	4,158,247
1928	..	..	..	..	..	4,488,243
1929	..	..	..	..	..	5,397,841
1930	..	..	..	..	..	4,629,757
1931	..	..	..	..	..	3,668,685
1932	..	..	..	..	..	4,915,423

The carry forwards are ignored.

At least two factors are worth consideration in looking at this exceptionally creditable achievement.

107. The capital, originally £56,802,996, was increased by the following amounts in the years indicated :—

					£
1927	..	..	..	..	1,366,853
1928	..	..	..	..	8,942,665
1929	..	..	..	..	19,678,763
1930	..	..	..	..	19,868,834
1931	..	..	..	..	20,295,199
1932	..	..	..	..	20,345,338

These figures are cumulative.

108. The profit return, after deducting amounts set apart to reserves, depreciation and obsolescence, on the share capital (taken as on the first day of each year) was :—

1927	..	..	..	..	7'3 per cent.
1928	..	..	..	..	7'7 „
1929	..	..	..	..	8'2 „
1930	..	..	..	..	6'1 „
1931	..	..	..	..	4'8 „
1932	..	..	..	..	6'4 „

The dividends actually paid were :—

					<i>Preference</i>	<i>Ordinary</i>	<i>Deferred</i>
					<i>Per cent.</i>	<i>Per cent.</i>	<i>Per cent.</i>
1927	..	..	..	..	7	8	1 $\frac{3}{4}$
1928	..	..	..	..	7	8	1 $\frac{3}{4}$
1929	..	..	..	..	7	8	2
1930	..	..	..	..	7	6	Nil
1931	..	..	..	..	7	4 $\frac{1}{2}$	Nil
1932	..	..	..	..	7	6	Nil

109. Bearing in mind that in the capitalisation of the company the exchange value of the shares was arrived at after taking into consideration future earning capacity and estimated increased profits, the achievement of the company, in view of the state of world trade, is quite noteworthy. It should be mentioned that in 1931, one million and a half sterling was transferred from general reserve to obsolescence reserve, and utilised to write off holdings in subsidiaries, while a sum of half a million sterling was taken from the general reserve for a similar purpose. In 1932 holdings in subsidiaries and other assets were written off to the amount of nearly four and a half

millions sterling by the application of a part of the obsolescence reserve and by a withdrawal from general reserve. Over thirteen millions sterling, however, had been credited to the general reserve from profits and capital accretions during the six years. These adjustments have left the obsolescence reserve standing at four millions sterling and the general reserve at nine and a half millions sterling.

110. From the point of view of the investor, our brief review appears to demonstrate great strength on the part of the company.

From the aspect of costing, clearly a reduction must have been effected, with a general resultant consequence of a fall in prices to the consumer. I have compared the prices of 137 classes of chemical productions for the year 1925 (prior to the merger) and for 1932, and find a material price reduction in over two-thirds of the commodities manufactured.

111. There remains for consideration the important question of labour. The closing of redundant works must have thrown thousands of men on to Unemployment Insurance benefit, but all the available evidence seems to demonstrate that both workmen and officials, whose retirement became inevitable, were treated with a consideration characteristic of the traditions of the original combining firms.

112. The figures are set out in Table VI of the appendix.

SHIPPING

113. It is not possible in this paper to do more than refer briefly to the scheme of arrangement carried through last year between the Royal Mail Steam Packet Co. and certain of its subsidiary and associated companies and their respective secured and unsecured creditors. The scheme is not a reconstruction of the group, and its terms do not apply to some of the companies associated with the Royal Mail group. The scheme applies directly to only fifteen companies with a total paid-up capital of £47,000,000, of which approximately £16,000,000 is held by the public, whereas the whole group comprises thirty-seven companies with a total paid-up capital of £82,000,000, of which approximately £26,000,000 is held by the public. The shareholders of the companies concerned have no voice

in the affairs at present, and their rôle is one of passive acquiescence. The creditors' claims which are affected directly or indirectly by the scheme approximate to £43,000,000, and the effect of the scheme will be the withholding by the creditors of their rights until December 1934. The only criticism I would venture to make is that the duration of the scheme, thirty-three months, seems hardly long enough to determine its success in dealing with the chaotic and conflicting claims and in ascertaining the potential earning power of the companies involved under normal trading conditions.

COMBINES AND LABOUR

114. This aspect of the question is rather beyond our professional experience, but anxiety is naturally felt at the continued tendency towards the displacement of labour through rationalisation. We have come to see that the actual employment of men for employment's sake is a valuable factor in national life, and I regret that "technological unemployment" cannot be a temporary phase, as in the early days of the Industrial Revolution.

On moral, psychological and financial grounds we cannot afford to have industry, through taxation, supporting a considerable percentage of unemployed persons capable of work. This decade has revealed the immense capacity of finance, organisation, science and labour for the production of natural and manufactured products. Accepting the tendencies towards technological unemployment and the continual increase of output, I suggest a new standard of thought may be required in the future in regard to hours of labour, the organisation of work and the amount of leisure time.

CONCLUDING REVIEW

115. Sir Arthur Salter, in discussing the effect of large scale organisation in relation to the economic crisis, considered that to some extent we had lost the advantages of free competition, while not securing the advantages of a deliberate system of large scale planning. He believed it was possible to combine private initiative with an element of deliberate planning. I am not clear as to the practical

implications of such a policy. It may be thought that in pursuance of a scheme of economic planning the extension of combines is inevitable ; but if I do not mistake the present temper of the public and shareholders generally, I perceive a distinct reaction against the extension and expansion of combines to the exclusion of business carried on in smaller units on a more independent basis.

116. We are living in times when prophecy is as difficult as it is dangerous. The combine movement has come to stay, but alongside of it we may reasonably hope that mankind will receive a generous measure of goods and services supplied by individual enterprise as well as by efficient combines.

APPENDIX

SUMMARY OF TWELVE CAPITAL REORGANISATIONS, 1928 TO 1931

	Capital prior to Reorganisation	Capital written down	Capital after Re-organisation	Further Capital Issued	Total Reorganised Capital
	£ s d	£ s d	£ s d	£ s d	£ s d
1928					
Sir William Arrol & Co., Ltd.	726,700 0 0	178,020 0 0	548,680 0 0	—	548,680 0 0
Partington Steel & Iron Co., Ltd.	1,600,000 0 0	1,483,333 6 8	116,666 13 4	819,607 15 0	936,274 8 4
Pearson & Knowles Coal & Iron Co., Ltd.	1,608,500 0 0	1,344,741 13 4	263,758 6 8	115,000 0 0	378,758 6 8
Baldwins, Ltd.	5,947,848 0 0	3,786,431 18 0	2,161,416 2 0	37,140 8 0	2,198,556 10 0
Crosses & Winkworth Consolidated Mills	4,000,000 0 0	3,000,225 10 0	999,774 10 0	260,000 0 0	1,199,774 10 0
The Rover Co., Ltd.	1,050,000 0 0	630,000 0 0	420,000 0 0	—	420,000 0 0
Armstrong Whitworth Securities Co., Ltd.	10,012,500 0 0	9,499,687 10 0	512,812 10 0	4,450,000 0 0	4,962,812 10 0
Sheffield Steel Products, Ltd.	450,035 10 0	396,378 9 0	53,657 1 0	441,167 19 0	494,825 0 0
Jute Industries, Ltd.	4,500,000 0 0	2,850,000 0 0	1,650,000 0 0	—	1,650,000 0 0
Lipton, Ltd.	2,850,000 0 0	1,827,500 0 0	1,022,500 0 0	—	1,022,500 0 0
William Beardmore & Co., Ltd.	3,025,224 0 0	2,885,112 0 0	1,040,112 0 0	2,114,847 0 0	3,154,959 0 0
Barrow Hematite Steel Co., Ltd.	916,965 0 0	812,500 0 0	104,465 0 0	591,854 0 0	696,319 0 0
1931					
	37,587,772 10 0	28,093,930 7 0	8,893,842 3 0	8,769,617 2 0	17,663,459 5 0
		76 per cent.			

Table 1, Paragraph 5.

Table III, Paragraph 60.

STATISTICS OF PAID-UP CAPITAL OF COMPANIES ON THE REGISTER AT
THE BOARD OF TRADE*All Companies on the Register, Public and Private*
(Private companies were first recognised 1907)

<i>Date</i>	<i>No. on Register having a Share Capital</i>	<i>Paid-up Capital £</i>	<i>Average Paid-up Capital £</i>
30th April 1885	9,344	494,909,862	52,996
1900	29,730	1,622,641,416	54,580
1910	51,787	2,178,619,734	42,069
31st Dec. 1920	79,541	3,508,012,486	44,103
1925	95,055	4,470,366,797	47,029
1926	97,588	4,636,613,382	47,512
1927	101,931	4,857,742,862	47,658
1928	105,729	4,977,914,258	47,082
1929	108,698	5,200,126,098	47,840
1930	111,861	5,484,449,672	49,029
1931	114,295	5,514,773,901	48,250
<i>Public Companies on the Register</i>			
31st Dec. 1926	16,240	3,180,459,019	195,841
1927	16,556	3,389,989,518	204,759
1928	16,735	3,516,634,773	209,539
1929	16,922	3,697,934,162	218,528
1930	16,263	3,893,937,840	239,438
1931	15,564	3,896,668,416	250,364
<i>Private Companies on the Register</i>			
31st Dec. 1926	81,348	1,456,154,363	17,900
1927	85,375	1,467,753,344	17,193
1928	88,994	1,461,279,485	16,420
1929	91,776	1,502,191,936	16,368
1930	95,598	1,590,511,832	16,638
1931	98,731	1,618,105,485	16,389

Table IV, Paragraph 61.

PROPORTION OF PRIVATE TO PUBLIC COMPANIES, 31st December 1931

	<i>No. on Register</i>	<i>Per cent.</i>	<i>Capital £</i>	<i>Per cent.</i>
Public Companies	.. 15,564	14	3,896,668,416	71
Private Companies	.. 98,731	86	1,618,105,485	29
Total	.. .. 114,295	100	5,514,773,901	100

Table II, Paragraph 58.

PAID-UP CAPITAL OF FOURTEEN LARGE

			1900		
			Shares	Debentures	Total
	Founded				
1 London, Midland and Scottish Railway Co . . .	1923				
<i>Midland Railway Co.</i>	1844	136,295,317	35,771,100	172,066,417	
<i>London, North Western Railway Co. . .</i>	1846	80,665,168	38,019,072	118,684,240	
2 Imperial Chemical Industries, Ltd.	1926				
<i>British Dyestuffs Corporation, Ltd</i>	1919				
<i>Nobel-Dynamite Trust Co., Ltd.</i>	1886	2,285,400		2,285,400	
<i>Nobel Industries, Ltd.</i>	1918				
<i>I.C.I. (Alkali), Ltd.</i>	1881	1,868,094		1,868,094	
<i>(formerly Brunner, Mond & Co., Ltd.).</i>					
<i>I.C.I. (General Chemicals), Ltd.</i>	1890	5,718,670	2,500,000	8,218,670	
<i>(formerly United Alkali Co., Ltd.). . . .</i>					
3 Unilever, Ltd.	1927				
<i>Lever Bros. Ltd.</i>	1894	2,927,068		2,927,068	
4 Cables and Wireless, Ltd.	1929				
<i>Eastern Telegraph Co., Ltd.</i>	1872	5,883,188	1,432,268	7,315,456	
<i>Eastern Extension Telegraph Co., Ltd. .</i>	1873	3,000,000	320,000	3,320,000	
<i>Western Telegraph Co., Ltd.</i>	1873	2,079,300	423,777	2,503,077	
<i>Marconi's Wireless Telegraph Co., Ltd .</i>	1897	137,083		137,083	
5 Imperial Tobacco (G. B.), Ltd.	1901	13,018,097		13,018,097	
6 Courtaulds, Ltd.	1913				
7 J. & P. Coats, Ltd.	1884	5,498,680	2,000,000	7,498,680	
		1903	1903	1903	
8 Underground Electric Railways Co. of London, Ltd.	1902	2,500,000	3,090,900	5,590,900	
9 P. & O. Steam Navigation Co.	1840	2,320,000	800,000	3,120,000	
10 Midland Bank Ltd.	1880	2,523,225		2,523,225	
11 Fine Cotton Spinners' Association, Ltd. . . .	1898	3,800,000	2,450,000	6,250,000	
12 Bradford Dyers' Association, Ltd.	1898	2,500,000	1,250,000	3,750,000	
13 Wall Paper Manufacturers, Ltd.	1899	3,155,355	986,113	4,141,468	
14 United Dairies, Ltd.	1915				

HOLDING COMPANIES (INCLUDING DEBENTURES)

1913			1920			1931		
Shares	Debentures	Total	Shares	Debentures	Total	Shares	Debentures	Total
160,189,004	43,583,782	203,772,786	160,284,443	43,608,655	203,893,098	304,637,238	109,141,619	413,778,857
85,864,132	39,022,334	124,886,466	88,862,857	39,022,440	127,885,297			
			9,202,093		9,202,093	77,098,194		77,098,194
3,285,400		3,285,400				4,775,580		4,775,580
			15,737,858	3,000,000	18,737,858			
4,031,870		4,031,870	11,023,544		11,023,544	14,197,965		14,197,965
3,423,926	2,770,000	6,193,926	3,425,240	2,665,000	6,090,240	5,077,740	2,627,760	7,705,500
11,704,258		11,704,258	46,769,079		46,769,079	14,138,750		14,138,750
						59,369,584	6,820,330	66,189,914
6,000,000	2,000,000	8,000,000	7,000,000	2,000,000	9,000,000	52,670,310		52,670,310
3,000,000	752,400	3,752,400	4,000,000	752,400	4,752,400	7,000,000	2,000,000	9,000,000
2,079,300	818,675	2,897,975	3,087,230	818,675	3,905,905	4,000,000	752,400	4,752,400
1,410,188		1,410,188	2,866,906		2,866,906	3,118,950	818,675	3,937,625
15,640,935		15,640,935	35,330,594		35,330,594	2,270,133		2,270,133
2,000,007	315,529	2,315,536	12,000,000	9,125	12,009,125	50,350,561		50,350,561
10,000,000		10,000,000	20,250,000		20,250,000	32,000,000		32,000,000
						20,250,000		20,250,000
5,059,948	14,430,400	19,490,348	5,059,948	15,135,450	20,195,398	10,700,990	8,023,000	18,723,990
3,500,000	1,800,000	5,300,000	6,632,465	1,495,880	8,128,345	7,632,518	8,487,560	16,120,078
4,348,650		4,348,650	10,859,340		10,859,340	14,248,012		14,248,012
5,700,000	2,750,000	8,450,000	6,390,000	2,750,000	9,140,000	8,350,000	2,750,000	11,100,000
3,856,477	1,453,750	5,310,227	3,856,477	1,453,750	5,310,227	4,808,031	1,453,750	6,261,781
3,187,355	996,113	4,183,468	4,359,453	1,028,445	5,387,898	4,600,000	1,014,214	5,614,214
1915		1915						
899,290		899,290	3,344,821		3,344,821	5,480,000		5,480,000

Table V, Paragraph 65.

TRADING RESULTS OF COMBINES

Net profits of 8 combines for the year ended 31st December 1931 (or nearest available date), compared with the net profits of 2,017 companies as shown in the *Economist*.

		<i>Total Preference + Ordinary Capital £</i>	<i>Net Profits Amount £</i>	<i>Per cent. of Total Capital</i>
Associated Portland Cement ..		6,000,000	399,963	6.7
Amalgamated Anthracite ..		8,682,121	289,478	3.3
Associated Electrical Industries		4,871,906	168,438	3.5
Cables and Wireless		52,560,310	636,168	1.2
Imperial Chemical Industries ..		77,098,195	4,408,290	5.7
Turner and Newall		6,288,127	360,879	5.7
Unilever		14,138,750	1,733,805	12.3
United Molasses		7,351,251	— 711,413	— 9.7
Total		£176,990,660	7,285,608	4.1
2,017 Companies ..		£2,435,170,964	139,436,950	5.7

*The *Economist* has arrived at this figure by taking the profit of the year and deducting the income-tax therefrom. My computation, used elsewhere, shows the net profits at £3,668,685, being the amount of the profits less the depreciation and obsolescence provided.

Table VI, Paragraphs 105/112 (continued).

IMPERIAL CHEMICAL INDUSTRIES LTD., Analysis of Accounts, &c., 1927-32

	1927	1928	1929	1930	1931	1932	Total
RESERVES—(1) Obsolescence.							
Profit and Loss Account ..		£ 509,138	£ 575,479	£ 500,000	£ 1,000,000	£ 1,000,000	3,584,617
Capital Accretions ..		2,500,000	415,383				2,915,383
Transfer from General Reserve ..	1932 £1,000,000						
Less Written off Subsidiaries ..	1,337,596				162,404		
		£3,009,138	£990,862	£500,000	£1,162,404	—2,662,404	—2,500,000
							£4,000,000
RESERVES—(2) General.							
Profit and Loss Account ..	408,977	1,000,000	529,020			500,000	2,437,997
Capital Accretions ..	291,023	6,300,000	4,195,980				10,787,003
Transfer to Obsolescence Reserve ..					—1,500,000	—1,000,000	—2,500,000
Written off Subsidiaries ..					—500,000	—725,000	—1,225,000
	£700,000	£7,300,000	£4,725,000	—	—2,000,000	—1,225,000	9,500,000
Capital at Incorporation ..				Transfers from Profit and Loss Account			4,797,614
„ 31st December 1932 ..		56,802,996		Capital Accretions			8,702,386
		77,148,334					
Increase ..		£20,345,338		Total Reserves (after writing off £6,225,000)			£13,500,000

Table VII.

CAPITAL ISSUES
(By Prospectuses or Offers for Sale)
Total offered for subscription (excluding conversions)

						£
1922	..	..	..	..	..	573,675,653
1923	..	..	..	..	..	274,399,173
1924	..	..	..	..	..	209,326,101
1925	..	..	..	..	..	232,214,500
1926	..	..	..	..	..	230,782,600
1927	..	..	..	..	..	355,165,970
1928	..	..	..	..	..	369,058,073
1929	..	..	..	..	..	285,239,400
1930	..	..	..	..	..	267,800,700
1931	..	..	..	..	..	102,044,291
1932	..	..	..	..	..	188,909,963

Taken from the *Economist*, 15th February 1930 and 4th February 1933.

Table VIII.

MONTHLY STATEMENT OF AVERAGE WEEKLY BALANCES OF LONDON CLEARING BANKS
(000's omitted)

1932, September	Barclays Bank, Ltd.	Coutts & Co.	Glyn, Mills & Co.	Lloyds Bank, Ltd.	Martins Bank, Ltd.	Midland Bank, Ltd.	National Bank, Ltd.	National Provincial Bank, Ltd.	Westminster Bank, Ltd.	Williams Deacon's Bank, Ltd.	Aggregate
	£	£	£	£	£	£	£	£	£	£	£
<i>Assets</i>											
Coin, Bank and Currency Notes and Balances with the Bank of England	37,938	1,559	3,032	37,329	8,190	42,092	3,027	27,656	28,468	3,384	192,655
Balances with, and Cheques in course of collection on, other Banks in the United Kingdom	6,630	476	685	6,122	1,660	6,283	158	6,346	6,386	1,302	36,048
Items in Transit	—	—	—	2,205	630	—	—	—	—	—	2,835
Money at Call and Short Notice	21,407	2,171	3,769	20,287	5,714	17,139	5,295	15,476	17,997	4,478	113,733
Bills Discounted	68,633	3,482	398	89,557	10,435	90,815	1,818	59,277	64,897	2,914	392,226
Investments	76,558	4,315	11,088	56,841	28,031	74,007	15,866	48,303	59,365	8,606	382,980
Advances to Customers and other A/cs	159,247	8,072	10,832	152,943	36,220	177,506	15,431	125,436	110,921	12,082	802,690
Liabilities of Customers for Acceptances, Endorsements, &c.	5,128	561	1,713	24,253	3,302	12,934	19	5,798	19,541	1,562	74,811
Bank Premises Account	7,265	412	605	7,938	2,948	10,810	772	7,193	5,864	1,047	44,944
Investments in Affiliated Banks	6,694	—	—	4,171	—	7,294	—	2,514	2,992	—	23,665
	389,500	21,048	32,212	401,646	91,130	438,880	42,386	297,979	316,431	35,375	2,066,587
Ratio of Cash to Current, Deposit and other Accounts	10 58	8 43	10 57	10 54	10 14	10 51	7 84	10 06	10 16	10 86	10 44
<i>Liabilities</i>											
Capital Paid up	15,858	1,000	1,060	15,810	4,160	14,248	1,500	9,479	9,320	1,875	74,310
Reserve Fund	10,250	1,000	530	7,500	2,900	11,500	1,030	8,000	7,500	800	51,010
Current, Deposit and other Accounts	358,264	16,487	28,670	334,078	86,752	400,198	38,571	274,702	286,058	31,138	1,864,918
Acceptances, Endorsements, &c.	5,128	561	1,713	24,253	3,302	12,934	19	5,798	19,541	1,562	74,811
Notes in Circulation	—	—	—	5	16	—	1,266	—	12	—	1,299
Reduction of Bank Premises Account	—	—	239	—	—	—	—	—	—	—	239
	£389,500	£21,048	£32,212	£401,646	£91,130	£438,880	£42,386	£297,979	£316,431	£35,375	£2,066,587

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Turner and Newall.

Unilever.

United Molasses.

DISCUSSION

THE CHAIRMAN : Ladies and gentlemen, owing to our time having been cut short, and in order to allow all those who have intimated their desire to take part in the discussion which will follow the reading of this paper, I regret it will be possible to allow only $3\frac{1}{2}$ minutes to each speaker, and I hope that they will do their best to keep strictly to this limit. I presume that each of you has received an advance copy of this paper. I also presume that you have, like myself, read it. If that is the case, I have nothing more to do than to have the pleasure of calling straight away on Mr. Hewetson Nelson.

MR. C. HEWETSON NELSON, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, by an inscrutable but benevolent providence, I have, as those of you who have read the paper will have observed, numbered my paragraphs. Consequently, all that I need to do in opening the discussion is to refer to those paragraphs which, in my judgment, seem to merit some consideration. The first paragraph is on page 385, paragraph 3, dealing with the important subject of decentralisation. The second paragraph is on the same page, paragraph 4, dealing with the no less important question of the law of diminishing returns. The third paragraph is on page 386, paragraph 6, dealing with the humanisation of industry, mass production. On page 390, paragraph 19, you have something about the factors of output, which may prove interesting. On page 400, paragraph 43, pages 400 and 401, paragraphs 44, 45 and 46, and page 402, paragraph 47, you have some account of the very interesting investigation and experiments made in the reorganisation of the Railway world. On page 412, paragraph 82, you have the conclusion at which I arrive with regard to the investigation of Banks. On page 414, paragraph 86, you have brought out the same thing in relation to the Insurance World and, finally, on page 423, paragraph 110, you have what I conceive to be a matter of monumental importance in the investigation of this subject, namely, the result of the independent examination of the price of chemical commodities, which shows that in two-thirds of those commodities the amalgamation of the Chemical Industry under the I.C.I.

has resulted in a reduction of the price of the commodities to the consumer.

THE CHAIRMAN : My Lord President, ladies and gentlemen, I have pleasure in calling on Dr. Walter A. Reid to open the discussion.

DR. WALTER A. REID, C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, this theme in the Congress programme is of consuming interest in world affairs to-day. It permeates the whole world of trade and commerce. It is presented in the form of a book of 51 pages written by Mr. Hewetson Nelson, F.S.A.A., of Liverpool. I have undertaken to open a discussion this afternoon. I understand a copy is in the hands of the members of the Congress interested. The author covers the subject from many angles—if not from all possible angles—and I am assuming you will expect from me only a general line of thought to bring out the phases of the problem most appealing at the present day.

Mr. Nelson clearly accepts the need of combinations with the general preamble of stability of prices, improved quality, economies in cost, and with scope for scientific research, while—paragraph 49—he stresses the “inherent prejudice of the public against combinations”; and again—paragraph 116—he writes: “The combine movement has come to stay, but alongside of it we may reasonably hope that mankind will receive a generous measure of goods and service supplied by individual enterprise as well as by efficient combines.” In the former quotation he speaks of “combinations” and in the latter “combines.” His meaning, however, is unmistakable; though “combinations” would include combines and associations, cartels for price-fixing, selling areas, pools, quotas, &c., &c.; but the word “combinations” may also refer to clothing the subject.

Paragraph 53, Mr. Nelson states: “The experience of older combines shows that deficient management and over-capitalisations have been the two vulnerable points.”

On the historical side Mr. Nelson’s review seems to be most exhaustive, as his criticism and his suggestions are of great practical importance.

Right away I say I am not going to write a treatise, nor am I to specify the virtues or errors of any of the combines or associations, but try to lead on to the problem of every-day needs. In the price of an article four voices are required, with varying tones of intensities. These are: Labour, with the loudest voice of all. Brains and enterprise, with restraint. The capitalist—that is, the shareholders—more or less quiescent, but they can be shepherded and led by leaders, more or less genuine. The patient

and good-natured consumer ; Balaam's ass only spoke once. And there is an intensified new force, in the modern power of the Press. I am prepared to admit the present-day need of capitalist combinations in industry, though only for the mighty populations, the masses of individuals, with increased demands for a higher scale of living, manifold requirements, for luxury, for comfort, for technical education, for recreation, &c., &c. These all necessitate new organisation, in management, in service, in the arts, in research, in inventions, in propaganda—all which are seriously affecting old standards of the domestic hearth and of craftsmanship. In passing, take (1) the tobacco combinations. The quality is good and the price is cheap. The slight competition is doubtless welcomed by the tobacco magnates. Their aim is geographical selling areas. Let them beware of women's fashions. If the ladies cease to smoke and return to chocolates what, then, for the dividends ? (2) Take Levers, in its foundations and great ramifications, at first concentrated, then wide, and then wild. The great pioneer desired to buy the world. First, he sold margarine for many years cheap, but it was not for love of his customers, nor even, perhaps, in keeping with the law of economic cost. The screw nail industry of half a century ago was not meant to be altruistic nor was it on a sure foundation for permanently serving the public. (3) Not much can be said in favour of the recent railway combinations. The size of the units meant an annihilation of local effort and incentive. With experience the railway magnates may soon again come into favour by new methods and cutting down of capital assets not represented by real values, but the cost of reconstruction will be colossal, and reactions far-reaching. There are visible signs of existing combines rectifying their errors in capitalisation, in sounder policy as regards diversified and unrelated activities, in practical as against theoretical qualifications for management, and in full co-operation industry with industry—not crushing out but rather encouraging competition, with the greater chance of progress through the stimulation of healthy rivalry. The ideal unit is when there is one co-ordinating personality with the instinct of decision and the practical knowledge of details—a man who would not, for example, have allowed the Vickers Engineering combine to buy and carry on a cotton mill. In that case two to three million pounds had to be written off capital. Nor would such a personality permit the setting up of water-tight compartments in management, without co-ordination. I have met cases where stocktaking was carried out from the office books. It cannot be denied that the aim of a combine is to snatch a monopoly—snuff out all competi-

tion. Disastrous results from these efforts have been frequent. A monopoly generally carries the seed of its own decay, in staleness and rivalries of huge staffs, also nepotism and inter-marriage of personnel without fresh blood. Railway companies have been blamed for that. Besides, a challenging monopoly is one day attacked by the patient consumer, and Balaam's ass will speak. This question of Government regulation is always present, and while great combines permit competition—though slight—and provide quality with price, say like tobacco or soap, there will be no need for Government interference, and far less for much dreaded nationalisation.

Two plain problems of common knowledge : (a) Price to the public 2s. Price to the producer 1s. To the middle man—100 per cent.—1s. Is that fair ? (b) How to let the manager manage and the director direct ? It is fundamental ; but this is not the time to enlarge on these conditions of successful achievement. Is there superabundance of food, &c., in the world to-day ? No. If the needs of Central Europe were met the surplus stocks would melt like snow in summer. Oh ! those exchanges ! Chinese puzzles !

Sir Arthur Salter remarks : " I perceive a distinct reaction against the extension and expansion of combines to the exclusion of business carried on in smaller units on a more independent basis."

There is profound interest in watching the proposals to save the world to-day by violent and speedy methods, glorifying the masses and leaving out the individual who still bears the responsibility. Wait and see. Doubtless the suspense or modification of democracy *is* required just at present.

There is no system perfect, but here's the test of the poet :

" For forms of Government let fools contest,

Whate'er is best administered is best."

MR. G. R. FREEMAN, F.C.A. (Great Britain) : Mr. Chairman, my Lord President, Mr. Nelson, ladies and gentlemen, one's first impressions on a perusal of this paper are that the author has given us the benefit of deep research and has collected a mass of instructive and interesting information, the detailed discussion of which will be impossible within the limit of time available during this Congress. For my own part I propose in the future to treat it as far beyond an address and more in the nature of a work of reference. I congratulate Mr. Hewetson Nelson most heartily on his splendid contribution to our deliberations.

Further consideration of the paper rather leads one to the somewhat

depressing conclusion that Mr. Nelson has not fully justified his assumption in paragraph 2 that "Capitalist combinations are a genuine attempt . . . to improve the general welfare of the people." This quotation reminds me of an opinion I ventured to express on a previous occasion to the effect that "change is not necessarily progress, and so-called progress does not necessarily always seem to be to the benefit of the greatest number." Undoubtedly there are many instances where capitalist combinations have been, in the long run, much more harmful than beneficial to the general welfare, and the evils have been accentuated by the temptation to over-capitalisation in some cases. You will gather from my remarks that I am to some extent an individualist, but at the same time I must confess that the tendency to capitalist combinations was bound to occur and is in my view likely to increase rather than to diminish. The effect will, of course, be that the "small man" will find his opportunities more and more circumscribed and instead of being the owner of his own business he will be in the position of an employee of some greater or lesser combination. There would even appear to be some trend in this direction in our own profession, and the concluding remarks of Mr. Keens yesterday afternoon in connection with Sir Albert Wyon's paper deserve careful consideration.

Detailed criticism of the paper itself is difficult as the author has dealt so fully with his subject and has fairly set forth different points of view.

In paragraph 23 Mr. Nelson refers to the form of combine which he designates "The Terminable Association." I think we may say that the "Shipping Pools" which were so much in evidence at the end of the last century were early illustrations of this form of combine. Properly worked, they were protection not only to the producer, but also to the middleman and the consumer by their maintenance of the stability of freight charges and thereby the fixity of one large item of cost to the importer in our overseas Dominions, or in foreign countries. Being loosely knit, however, they are usually vulnerable either to outside competition or to internal dissensions. Some 25 years ago I was concerned in the affairs of a man who, by somewhat unscrupulous methods, succeeded in forcing a combine of this kind to give him preferential treatment, with unfortunate results to the traders of the country to which the particular shipping lines operated. His action temporarily forced down the price of a certain commodity in that country, with uncertainty as to the future trend, not only of price, but also of supplies. This uncertainty greatly upset the market, and most of those interested either as producers,

shippers or consumers, were relieved when the "ring" was re-formed and prices again became fairly stable, though at a higher rate than had formerly prevailed.

I would call your particular attention to Mr. Nelson's quotation from Dr. Coates, in paragraph 44, and I venture to suggest that many of the combines which have taken place since the Great War have experienced some of the pitfalls so clearly set out by Dr. Coates.

Referring to paragraph 60 and Table III on page 427, it must be remembered that the expression "private company" is a legal one, and embraces not only small concerns with only a few shareholders, but also a fairly large number of companies with considerable capital which are subsidiaries of holding companies. If these subsidiary companies were placed in a different category one would imagine that the average paid-up capital of the remaining "private" companies would show a greater decline than £1,511 between 1926 and 1931.

A recent illustration of the class of combine referred to in paragraph 66 is the London Passenger Transport Board, to co-ordinate the whole service of public carrying passenger vehicles in the County of London and neighbouring districts. It is, I believe, common knowledge that Sir William McLintock, a distinguished member of our profession, has been mainly responsible for the complicated and varied financial arrangements involved in this combine.

The banking amalgamations mentioned on pages 408 and 409 have undoubtedly enormously strengthened the financial position, but one hears many complaints as to the inelastic attitude of the "Big Five" in connection with overdrafts or bonus to small traders and others. It may be that, in the old days, private banks were too generous in this respect, and that this is an explanation of the failures in certain years of the nineteenth century, as recorded in paragraph 73. On the other hand, one sometimes comes across apparently harsh refusals for accommodation and the rate of interest charged by the banks does not accord with the meagre interest allowed by them on deposits. The fact that advances to customers by the London Clearing Banks (paragraph 81) had decreased in September 1932 by 108 millions as compared with September 1931 must mean that to some extent the banks are less ready to utilise their funds in this way, with consequent detriment to the trade of the country. I know I will be told that I am putting effect before cause, but personally I am satisfied that there is some measure of truth in my contention.

The remaining pages of Mr. Nelson's paper are mainly statistical, but

they are of very great interest and will repay careful study.

I will conclude by repeating my thanks to Mr. Nelson for his most instructive paper.

MR. WALTER HOLMAN, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, before I venture to comment on the paper which has been placed before us this afternoon I wish to acknowledge our indebtedness to the writer for the patient research involved in the compilation of so comprehensive a survey of recent industrial development. The application of accountancy principles to that development was considered yesterday afternoon in the paper on Holding and Subsidiary Companies, and my only complaint on that score is that this paper should have been the prologue to the other and not the epilogue.

The writer of this paper starts with an assumption which in my view is altogether too wide to be applied generally. He assumes " that capitalist combinations are a genuine attempt to improve the trade of the world, to provide the reasonable reward of capital, of enterprise and of labour, and to improve the general welfare of the people." I think that in making such a statement the writer's wish is father to his thought. While undoubtedly such altruism does exist in the world I suggest that it is not conspicuously to be found in industry, and I suggest that a truer assumption would be that capitalist combinations are an attempt to reduce and ultimately to eliminate competition. Mr. Hewetson Nelson quotes examples where that has been the object and the effect of some capitalist combinations, but he seems to regard it as an incidental rather than a fundamental consideration. That is where I join issue with him.

I am not going to condemn rationalisation on that ground, for unrestricted competition may be as harmful to the true interests of industry as the entire absence of competition, but I do want to point out that as the unrestricted individualism of the Victorian Era led to the exploitation of the worker so rationalisation, unrestricted by the corrective of competition, may lead to the exploitation of the consumer. And in support of that statement I need only refer you to the impressive example given in paragraph 37 where the writer deals with the syndicate formed for the control of potash. No industrial system has yet been evolved which is free from the possibilities of abuse in one direction or another, and unless there exists some check on those abuses they will ultimately wreck the system. I suggest that competition is the automatic check on the possibilities of abuse which are inherent in the capitalist system as we know it in this country, and if and when competition is entirely eliminated the

system will be in danger of dissolution.

I have not overlooked the fact that in some directions the process of rationalisation has produced an intensification of competition and a consequent benefit to the consumer, besides providing a stability which is of direct benefit to the community. This is illustrated by the particulars given in the paper in regard to banks and building societies. My purpose is not to dogmatise but to point out what seems to me to be one direction in which danger may exist, namely the exploitation of the consumer ; and another danger lies in the possibility of internal slackness, in the wastage of overlapping and excessive overhead charges. Mr. Hewetson Nelson has hinted at these in the example he quotes in regard to railways. He refers to the enormous economies which have been effected in the reorganisation of a particular railway, but it is, I think, fair to point out that the state of things which made the reorganisation necessary arose under a monopoly in which there had been little or no general competition.

In pointing out these dangers of rationalisation I do not wish it to be thought that I am necessarily opposed to the principle. I take it that our duty as professional men is to foresee the dangers as well as the advantages of the developments which are going on in our midst, so that our advice may help to avoid the dangers and preserve what is valuable. That there are great possibilities for the good of industry in the extension of the principle of rationalisation can hardly be disputed ; it is our duty to see that the good of industry does not conflict with the good of the community.

MR. G. E. WATSON, F.L.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, I would add my congratulations to Mr. Nelson, on the very complete and efficient manner in which he has dealt with a vast subject of extreme importance to commercial life generally.

The subject is of special interest to the accountancy profession throughout the world, and we shall obtain knowledge and guidance in studying the subject from its many points of view. I think we all appreciate the benefits which might accrue from combines, and realise how necessary they are in many phases of business life, but we should also seriously consider their disadvantages under certain circumstances, and by discreet advice endeavour to direct our clients along the proper course. There is a real danger, in my opinion, of assuming that if we can only enlarge a concern we shall, as a consequence, make it more efficient. Mr. Nelson has rightly pointed out we may by so doing hide some of the defects

which might be apparent in a smaller undertaking, and a weaker and unprofitable unit is often bolstered up and continued at the expense of the larger concern.

There are four points I should like to comment upon which I feel are of great importance to the accountancy profession. We, in this country, are proud of the strength and security of the British banks, but the Treasury Committee in 1918 realised that there is a real danger of a monopoly being created if further amalgamations are permitted. The creation of the Big Five has not always been helpful to the smaller customer, who has found it more difficult to obtain accommodation unless he has been able to lodge adequate cover, whereas the examinations which have taken place after large commercial disasters, have revealed that big business has been virtually "run after," with subsequent losses.

My next point, so far as the banks are concerned, is that they are in a unique position for obtaining the confidence of their customers and the way they are obtaining work previously entrusted to the practising accountant is rather disconcerting. A real effort should be made by the profession to see that no undue pressure by the banks is brought to bear on any customers and that no further inroad is made into the accountants' domain until, at any rate, such times as the law shall state only the accountant in practice shall be permitted to carry out those duties which should rightly be their prerogative.

Another problem which has affected the practising accountant, probably more particularly in the Provinces, was yesterday referred to by Mr. Keens. Great numbers of small concerns have been merged into larger units and as the control of the combine is usually in the larger cities, accountants in the smaller towns have found the audits of some of the concerns which they have nursed from the infancy of the business, being taken over by the nominees of the adopted parent. The only outcome, I suppose, will be to find practising accountants more and more concentrating in the larger cities, and possibly in larger firms.

My final point is that cost of living should be kept at a lower level by combines if under proper control, and no monopoly should be allowed to be created which will prevent this object being achieved. The accountancy profession has, however, to my mind, a real duty to perform to try and assist in suggesting ways and means of meeting the large displacements of labour caused by rationalisation and of reducing the unemployment figures which are troubling most countries at the present time, reliance being placed on the accountant in future for his views and

guidance in this respect, and it is up to the profession not to be found wanting.

MR. G. J. P. HOGEWEG (Holland) : Mr. Chairman, my Lord President, ladies and gentlemen, it is only natural that a paper written by the eminent author of the lecture "Standard costs as a basis of Management and Industrial Control" at the Congress in 1926, held at Amsterdam, should attract the attention of the Dutch accountants. Also in this instance the writer shows the vast extent of his reading, which has enabled him to give us an abridged account of the origin and the objects of capitalist combinations, worthy in every respect of the attention of the world at large. As a matter of course, part of the writing was bound to be known by the accountants, but, notwithstanding, many others will have felt like me, who have read this brief historical outline with much satisfaction.

The object of the capitalist combination is regulation of production and prices ; but the writer could also state that in the majority of cases prices were kept fairly low. Nevertheless there are amongst the eight objects in view named in paragraph 42 some which might lead to fairly high prices, for instance the maintenance or increase of profits to shareholders ; generous allowance for depreciation and obsolescence and the maintenance of good relations with labour and an improvement in labour conditions.

Under more or less normal circumstances shareholders, judging by the dividends distributed, are well looked after, and the provision for obsolescence, which is so highly necessary in such modern enterprises, weighs heavily on the cost prices. In such protected industries wages are generally high and labour conditions good. In industries like these the necessity of conforming to unfavourable general conditions is generally less quickly realised and they form an obstacle on the road to a general adjustment of wages to the reduced standard of living. When viewing capitalist combinations in the light of present-day needs we surely cannot omit making this observation.

As regards the advantages caused by the development and application of scientific research it cannot be denied that much has been done in this direction by the combines. I should like to draw attention to the very important results attained in this regard in Holland by the co-operation of industries which in all other respects are totally independent of each other, and also to the endeavours of the management research groups, a great number of which have been operating in England for many years

and which also in Holland can in many instances boast of good results. For those purposes, therefore, capitalist combines are not strictly necessary. The object may also be reached in another way, which is borne out by practice. The combine no doubt renders the financing and the management of this research work much simpler, but the object can also be attained along other paths.

Very special attention should be drawn to paragraphs 55 and 56, in which the writer points out that the combines have not been able to alleviate the economic consequences of the depression and that, on the contrary, they have possibly been "an aggravating factor." This remark tends in the same direction as my previous observations in this regard. Many of the combines which existed at the beginning of the crisis, have not been able to pull through, or will, in all probability, not survive the crisis and either have been or are being re-organised. The writer mentions this and furnishes interesting details. Shall we in that case witness a return of a greater number of smaller and independent industries? The writer points out that in England beside the "big business" also the "small business" has continued to exist. This is not only in England but in many, perhaps in all, countries. Is the only reason for this the fact that people in the industries are not persuaded that individualism in relation to business is effete and redundant? I should say "no." If the economic laws rendered the creation of "big business" absolutely necessary the more feeling entertained in this regard by the leaders of the industries would not enable them to oppose such a tendency. They would surely be compelled to give up their "small business."

The writer simply informs us that the small concerns not only continue to exist, but that their number is still on the increase. I should like to direct attention in this connection to a number of once universally known combines that have been wrecked. There are apparently counteracting forces in economy which reduce the advantages of the "big business" and under certain circumstances cause them to fade away. And yet there are many economists whose only hope of the future exclusively depends on the "big business" with its possibilities of "planning."

I regret that I have vainly looked for a theoretical analysis of the advantages and drawbacks of the "big business" as compared with the "small business" and an exposé of the economic forces which apparently are opposed to each other in the "big business." Such a theoretical analysis is necessary. Only by this will it be possible to obtain a true insight and to circumvent mistakes previously made; only thereby

will it be possible to obtain in the long run the greatest yield by the smallest possible sacrifices and that is beyond doubt the aim of all economic studies.

Possibly Mr. Hewetson Nelson may have an opportunity of going further into this matter in his reply, or otherwise he will no doubt be good enough to give us his views regarding these points on some future occasion.

MR. GODFREY CRAVEN, F.S.A.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, it seems to me that my remarks are going to be very much an echo of what has been said already. It comes rather as a surprise to me that accountants so far seem to dislike combines in industry. I would like to thank Mr. Hewetson Nelson for a most excellent paper, which seems to have dealt with every aspect of the problem of combines, but I would just like to stress one or two points which he does not seem to have dealt with with sufficient seriousness and which, to my mind, present very considerable difficulty. Despite a very bare reference in his concluding remarks regarding individual concerns in the smaller companies, I feel that he has not attached sufficient importance to the dangers of combines. There is no doubt whatever that transport and public utility companies should have a certain measure of monopoly, but at the same time there are numerous cases of its disadvantages. As a practising accountant I have in my own sphere found many instances where the transport of goods is, shall I say, almost hampered rather than facilitated by the railway companies. The lecturer has mentioned the question of maintenance of prices and the protection of producers against unfair or cut-throat competition. He does not point out that that is an endeavour in which many of them indulge in order to obtain the monopoly which everything should be done to prevent. He also refers to the public attitude but in this connection he mentions only the relations between the combine and the consumer, and makes no mention of the industrial policy which has as its consequent result considerable unemployment among all classes of employees, both the workers and the administrative side. I cannot help feeling that combines are not barriers against depression and that we cannot lightly disregard, as the lecturer says, the spirit of independence and self-reliance. I feel that the spirit of self-reliance and private enterprise is something for which we should strive in our relations with industry, and that we should do everything possible to prevent the growth of these large monopolies, which tend to crush out anything which shows a tendency towards enterprise for the furtherance of industry and trade generally.

These arguments are, of course, too brief to draw any conclusions on theory or policy, but are intended merely to develop a point of view which I do not think the lecturer has dealt with at quite sufficient length.

MR. DAVID ALLAN HAY, O.B.E., C.A. (Great Britain) : Mr. Chairman, my Lord President, the speakers who have just followed the reader of the paper have touched on a good many of the aspects of this question which have appealed to me. I think to-day we are, as commercial nations, too much inclined to worship mere size. Whether we have got that from our cousins in America or not I cannot say, but in this whole question of the combines and their development one finds that there is not only gain but very definite loss. Mere size, mere output, mere magnitude of figures, are not everything, if in the process of achieving these things we make some losses and encounter some drawbacks, and I would suggest to you that sooner or later in this country there will require to be a closer watch kept upon combines, a kind of watch which cannot be exercised at the present time by shareholders, whose views at annual meetings and in effective control are very small indeed. And I suggest that there is a danger in these great combines that where you have a very strong personality in control you have the elements of greater disaster if that personality either runs riot or, being efficient, is removed at a critical time in the history of the company. We have seen in this country a number of examples of great combines with dominating personalities running them which have landed the concerns in very great financial difficulties. It is not possible for us as accountants in our sphere as auditors effectually to criticise or even seek to control that tendency, but we are asked in our professional capacities to advise industries or companies engaged in industries whether they should enter into a combine, whether they should sell out and receive a cash price for their business, or endeavour to carry on and hold their industry's flag aloft in their own district. One has got to give that kind of advice purely impartially, and with the best interests of the client before you, but I do suggest that there is national loss in this development of combines. A great deal of interest and control and of effective local interest has been removed by combines, greatly to the loss of the provincial centres of this country, and I do suggest, in conclusion, that though as accountants we can only watch the development, at the same time we can do what we can to limit the worst features of combination and try to maintain the human element, the human interest, and the local interest where we possibly can.

MR. PERCY H. WALKER, F.S.A.A. (Great Britain) : Mr. Chairman, my

Lord President, ladies and gentlemen, Mr. Hewetson Nelson, in his excellent paper, has given us that well ordered array of facts and logical reasoning we always associate with his writings. Whilst he has not failed to point out some of the weaknesses of capitalist combinations, he certainly inclines to the view that the trend is all to the good and it is on this point that I am tempted to break a lance with him.

In the first place, like so many of our capitalists, he appears to have read the recommendations of the Committee of Industry of the League of Nations in 1927 in such a way as to concentrate on the one aspect of rationalisation, namely, amalgamation to the exclusion of all others. I cannot help feeling that considerable mischief has been done by the somewhat glib use that has been made from time to time of the recommendations of that committee by capitalists who for their own ends have brought about combines which in no way benefit the general community. After all, amalgamation was only one of several recommendations that that committee made for the suggested improvement of trade conditions, and by no means the most important.

As Mr. Hewetson Nelson himself states, a number of combinations have taken place which were not necessarily a response to any sound economic principles, but seem to have arisen from the conjunction of opportunity and leadership. It is this very conjunction of opportunity and leadership which is to be feared because of its consequent risk of exploitation. It is particularly noticeable in South Wales, where practically all the colliery companies, and particularly the anthracite collieries, have been combined by means of capitalist combinations into one or two groups. Prior to these amalgamations local capital was invested and local labour employed in a large number of separate companies and separate collieries. The combine has closed down many of the pits rather than expend further capital in modernising their equipment, with the result that in many cases the only money which finds its way into the mining towns and villages is that which the one time colliers receive as unemployment benefit.

It has always been a mystery to me why greater use has not been made among the great producing industries of the co-partnership movement which has proved such a complete success in the case of the great gas undertakings. The Report of the Coal Commission made some very definite and trenchant recommendations in this connection. It stated that had some of the surplus profits which from time to time had been distributed as bonus shares to the shareholders been utilised in making their em-

ployees co-partners in the undertakings, it would have been all to the good of the industry. Here you have a form of combination where the maintenance of good relations between capital and labour and the improvement of labour conditions are bound to follow automatically. What is more, in the Co-partnership Movement, one of the great weaknesses both from a national point of view and especially from a civic point of view of the capitalist combine, namely, the suppression of individual development is avoided. The closer co-operation between labour and management tends directly to develop the individual, whereas the capitalist combination must of necessity tend in the other direction. It is interesting to note that Dr. D. H. Smith, in his review of the Industries of Greater London, points out that in many firms employing 200 to 500 people there appear to be only one or two responsible persons capable of controlling policy and initiating changes. I suggest that one of the reasons for this is that the unit becomes so unwieldy that the vital element, the human touch, is bound to suffer. The ability to control is there, but through lack of appreciation and encouragement it languishes, and eventually dies.

Again, under any form of combine with its consequent growth of the producing unit, the joy of craftsmanship is bound to suffer. What man can take real pleasure in creative work when his share of it merely consists in the turning of a portion of an engine on a turn-table? You cannot make good citizens out of human robots. The growth of multiple shops and chain stores and the substitution of the branch store manager for the individual shopkeeper has removed from our civic life a class of man who with a definite stake in his City was particularly well equipped to control its affairs and especially its finance.

I cannot help feeling that capitalist combines are bad for the three following very definite reasons :—(1) They are bad for the individual as they lessen his opportunities of advancement ; (2) they are bad for the civic life of the community by the reduction of financially interested ratepayers, and (3) they are bad for the nation, as a whole, as the concentration of financial control into a small number of immense units renders the exploitation of national and racial prejudices for the benefit of some particular vested interest only too easily capable of attainment.

I think that the reaction that Mr. Hewetson Nelson refers to against the extension and expansion of combines is a very real one and a very healthy sign and that it is the disintegration of some of the present cumbersome combines, rather than the setting up of further combines, that the hope of industrial development and recovery may be looked for.

MR. C. N. DOLBY, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, the paper which has been so carefully and thoughtfully prepared and upon which I venture to offer some observations, covers such a large field that it would be impossible, in the few minutes allotted to me, to deal with all the points which have been touched upon by Mr. Hewetson Nelson. Even if time permitted, I doubt whether some of the problems put before us to-day are capable of useful discussion except from an academic point of view, or on a purely hypothetical basis.

Large scale combinations or rationalisation of industry, as we understand it, so far as this country is concerned, are in nothing more than an experimental stage. Consequently we have not at our disposal that wealth of data, either of a statistical nature or otherwise, that would, if available, afford us some guide as to the advantages or disadvantages of capitalist combinations. After all, the probable future trend of any movement can only logically and intelligently be forecast by a consideration of past events and where this is not possible we descend to the realms of speculation and sheer prophesy.

Then again—limiting my observations to events in this country—rationalisation of industry has come to the front during an abnormal period, a period distinguished chiefly in the catastrophic declines in commodity prices and a hitherto undreamed of collapse of the economic fabric. I suggest that these conditions have successfully clouded the issue and to a large extent distorted our vision. Obviously, with one hundred factories working half-time, it needs no great concentration of one's intelligence to offer the simple remedy of amalgamating those 100 factories, closing down 50 of them and leaving the other 50 to work full time. But are we satisfied, if and when trade revives to such an extent as to require the output of those 100 factories, that there has not been set in motion an upward movement of prices which may not be arrested without State intervention, with all its consequent evils ?

The past few years, as I have already indicated, have been years in which supply has outstripped demand, and as a consequence the risk of extortionate profits being made at the expense of the consumer has been negligible. But I submit that the risk would be a serious menace if economic conditions once more regained an equilibrium and demand became equal to, if not exceeded the supply. I am not persuaded, in spite of seductive speeches to the contrary, that capitalist combinations, given the opportunity, are so inhuman as to refuse large profits when circum-

stances are sufficiently propitious. This, I submit, is a vital aspect and one which must not be overlooked.

The extract from the *Edinburgh Review* which forms the opening to this paper engenders a feeling of optimism justified by the happenings during the last 100 years. But these 100 years have been signalised not by the efforts of large trading concerns with capital at their disposal running into many millions of pounds. Rather have they been renowned for the extraordinary courage, initiative and sheer hard work and concentration shown by individuals who in many instances were pioneers. It surely cannot be seriously suggested that the qualities I have just mentioned are to be found to anything like the extent necessary at a time like this, in the combined personnel of a company with a capital of say £50,000,000. I come from a City in which has been built up during the past hundred years a great shipping industry, and it has been built up by individuals whose names are known in all parts of the world. I desire to draw no false conclusions, but it is nevertheless significant that in spite of the amalgamations which have taken place in that industry and which have been attended by such disastrous results, at least one firm has remained to my knowledge, unabsorbed, has not even adopted limited liability, and is conducting a successful business to-day.

Great efforts are now being made to raise the price of commodities. As I understand it, the object is to so raise the purchasing power of the people of the country producing the commodity as to enable them to become a more potent force in the world's markets.

Now one of the primary objects for the establishment of large undertakings, through absorption and amalgamation, is the desire to bring about a substantial reduction in the costs of production. This is effectively brought about by, *inter alia*, closing redundant and inefficient factories and reducing general overhead expenses. I must here remark that I am not referring to the reduction in the ratio or percentage of overhead expenses to output brought about by an increase in the turnover. That, of course, is not a literal reduction in overhead expenses. The effect of these reductions must be reflected by reduced purchasing power of those who have been in the habit, either by direct or indirect employment, of rendering services to the producer.

There does appear to me to be a possible contradiction of policies if the efforts to raise commodity prices and the efforts to reduce costs of production are attempts which can both be regarded as well founded in theory and both capable of producing in practice the desired results.

In conclusion, Mr. Chairman, I emphasise the fact that the information at one's disposal is not sufficient to enable an intelligent forecast of the advantages of capitalist combinations to be undertaken, but as yet I have read nothing nor heard anything which convinces me that individualism, with its enterprise, its courage and its tenacity of purpose, cannot, or will not, if given reasonable freedom from State interference and reasonable banking facilities on sane and practical lines, provide a solution to the problems which beset us to-day.

MR. ALEXANDER HANNAH, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, my contribution to the discussion this afternoon is more from a desire to pay tribute to my fellow townsman, Mr. C. Hewetson Nelson, than any conviction that I can contribute anything really useful to the discussion. I do offer him my felicitation upon the successful way he has dealt with so very important a subject to accountants.

I think it is agreed that rationalisation of industry and capitalist combinations are not yet a proved success but perhaps the period of experience is not yet sufficient to enable a definite opinion to be formed. There are, however, one or two features which to my mind will have to receive the serious consideration of those engaged in the study of this subject. In all types of large scale capitalist combinations in industry there are two points which appeal to me particularly. My first point is that I think it is becoming increasingly apparent that in the case of the large public company the present method of appointment to the board of directors is not effective. As we know, in most cases, new members are co-opted by the existing board (subject to formal ratification by the shareholders) and it is most unusual to drop a useless director.

The question of management of large scale industry (particularly socialised industry) will soon, I think, disclose difficulties in staff promotion methods. Most of our present leaders have been discovered by the competition method, often commencing in small businesses, but twenty years hence the then captains of industry will have emerged from the ranks of the staffs of the large companies, their progress mainly dependent perhaps upon the recommendation of their immediate supervisors at each stage. If a key position on the scale is occupied by a man jealous of his own position, or otherwise incapable we know what happens. The remedies are, I think, an enlightened recruiting policy and more especially adequate facilities for transfer from one department or branch of the business to another. This privilege is, for example, the saving grace of the

banks and municipal services.

My second point is supply of capital. For various reasons it seems to be becoming more difficult to obtain capital for small concerns say up to the £50,000 mark. A public issue is expensive, the banks will not lend permanent capital, and the moderate investor, deterred by income-tax and death duties, is less adventurous than hitherto, probably feeling safer with public authorities or large companies. Even assuming that the large undertaking is desirable in many industries, it seems to me that it is essential under any capitalistic system to keep these smaller concerns in active existence particularly in connection with luxury or experimental articles.

The solution may be that it will be found possible to establish a series of provincial investment companies, which will borrow on a large scale by public issue and lead to approved smaller companies on debenture. Such a scheme might do more to revive industry than the famed remedy of a low bank rate.

Then there is the question of the relationship between the capitalist concern and the State. There is an undoubted tendency towards State control of industry, particularly in necessity trades, the line of evolution being perhaps indicated by the Metropolitan Water Board set up in 1902, the London Passenger Transport Board and President Roosevelt's Industrial Recovery Act. The major problem will probably arise when the State-controlled industry of one country comes into direct competition with the privately controlled industry of another country.

Whatever happens now, with a hundred million years before the human race, there is plenty of time for experiment, while it is clear that whatever development takes place there should be ample scope for the accountancy profession.

MR. A. STUART ALLEN, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, Mr. Hewetson Nelson has presented a survey of the subject which is wholly admirable in its range and its impartiality, and, moreover, he has avoided the temptation to devote undue attention to probable political and social reactions and to the general economic aspects of his subject.

While more recent experience has in some degree dampened the immediate post-war enthusiasm for trade associations and combines, it is indubitable that they will continue and increase. In present circumstances it is of the first importance to seek the method by which this tendency to combination can be controlled and directed into channels

which will confer the maximum possible benefit on the community at large. This aspect of the matter must clearly be dealt with fundamentally in the truest sense of that word, and it is therefore interesting to survey what may best be called the inspirations to combination. For present purposes I propose to divide inspiration into two broad classes—First, individualistic inspiration, and second, Governmental or semi-official inspiration. The former class again falls into two broad divisions :—

The first and more exceptional emerges when a dominant personality arises in a particular industry whose genius and far-sightedness only find full scope within an amalgamation of a number of important units in that industry. Apart from the danger that such genius may deteriorate into megalomania leading to a combination which is unwieldy, the resultant organisation is likely to confer great benefits upon the community, upon the industry and upon the employees, if humane considerations are given due weight. There is usually difficulty in adequately ensuring the succession to such an industrial kingdom, when the progenitor has been translated to another sphere affording, one hopes, an even wider range for his genius. Admittedly, such organisations gain momentum which tends to ensure adherence to the course originally laid down, but once the dominant personality has been removed there is an inevitable and possibly greater tendency for the executive to become sectional so that the original plan becomes distorted out of all resemblance to its pristine form.

The second sub-division of combination, owing its origin to individual inspiration, can be dismissed in a very few words. Into this class fall all combinations usually formed in times of prosperity, values already abnormally high being frequently aggravated in the course of the negotiations. Here, the main urge is really hardly more than the appetite for promotion profits, and there is little planned economy from start to finish. Governmental or semi-official action or pressure is always reluctantly applied and, save in the case of public services, action of this character is usually taken in times of depression when an industry or an important section of it is threatened with collapse. Such agglomerations have few merits and many disadvantages, exigencies being more dominant than future requirements. The risk of failure is unduly high, and with failure the reluctance of the Government to intervene on other occasions is enhanced.

Turning to another aspect of this absorbing subject, a purely horizontal combination is rarely to be found. The temptation to provide the huge

material requirements at cost price leads to vertical development. Producers of the materials are absorbed or new factories are erected ; in either event the home market remaining available to independent producers is narrowed down, which may have adverse results on their competitive power, particularly if the product is also sold for export.

Then I must refer to the displacement of labour by mass-production methods. As Mr. Hewetson Nelson himself has said, the original conception that such displacement is essentially temporary and rapidly taken up has been falsified by experience and the problem is being freely debated at the present time. The difficulties in the way of the obvious remedy of a shorter working week are clearly enormous, merely from the one aspect of widely differing national conditions. Is it conceivable that Japan, for example, will lightly sacrifice the advantages which she at present derives from an abundant supply of the cheapest labour, existing under conditions which are well below the barest subsistence level of any Western country ? The possible effects of a considerable increase in leisure on the morale of the working classes must also not be left out of consideration. We have, therefore, the position that as combinations in industry continue and increase, so far-sighted planning and control become more imperative. That this control should be a Governmental function seems neither feasible nor desirable ; in fact, it is difficult to perceive how direct control in any form could be imposed with advantage.

How, then, are we to make progress and get away from the haphazard methods of the past ? The national genius for compromise suggests a solution. I have in mind a committee under the ægis of the Board of Trade, with a constitution somewhat similar to that of the Board of Referees ; this committee to hold sessions from time to time as might seem expedient, with power to demand information, to call witnesses and to collate, codify and publish this material and advise the board thereon ; the findings of the Committee to be published subject to the approval of the President of the Board of Trade. In this way there would gradually be built up a body of authoritative opinion which would be a guide to those seeking combination or amalgamation in the best interests of industry, and a deterrent to others actuated by baser motives. The function of such a committee would, in effect, be largely educational, and this, when everything is said, is the only sure means of progress.

Finally, considering consumption, is it permissible, on such a purely mundane subject, to dream the dream that a not unimportant section of consumers could be educated to prefer goods produced by the hands of

craftsmen to those resulting from mass production methods and thus tend to revive and re-establish a type of activity which is rapidly becoming extinct. To become purely nationalistic—an attitude which is not without a certain factional popularity—reference can usefully be made to the reactions of any projected combination upon income-tax liabilities. In practice one is frequently faced with severely adverse results, sometimes not merely upon the amalgamating companies, but also upon the members of the personnel. That the income-tax is likely to remain an important factor for several years to come is hardly in doubt, and in uttering this word of warning I wish to point out that forethought upon this troublesome but none the less important aspect can certainly minimise the hardships and may even result in definite advantages by the introduction of modifications which do not vitally affect the whole scheme.

MR. GRIERSON MACARA, J.P., F.C.R.A. (Great Britain) : Mr. Chairman, my Lord President (I am glad to be able to say also, ladies and gentlemen, and to compliment the ladies on continuing to attend through our sittings): Mr. Nelson has referred in his comprehensive paper to the large number of small businesses or small concerns still in existence. That, I think, is a very gratifying feature, because individual initiative is vital to great communities and nations like ours, and we all know that initiative gets a much better chance of developing in the hands of a large number of small businesses than in huge combines. It is far better to have that than to have all the traders as mere cogs in some gigantic wheel. Of course, there are defects in the small trading system ; the small shop-keeper, for instance, who carries on in a rule-of-thumb way and who pays little or no attention to reserves, depreciation and so on. The Companies Act, with all its consequences, largely changed that state of affairs ; it brought out in a very definite way the need for the accountancy profession, and gave the accountant an opportunity of making himself felt in the trading of the community in practically a new way. I hope the influence of accountants will increase in that direction. I do not see why the larger companies should not all have accountants as members of their Boards. I do not, of course, mean that the auditing firm should be represented on the Board, but an independent accountant would, I think, be of value to the large companies such as we are accustomed to to-day, where finance and the proper control of finance are of vital importance. Some of the amalgamations that we have to-day are, of course, too big—like the railways. I understand that a trader in the north of Scotland, for instance, making inquiry about anything special

has his inquiry referred to headquarters in London.

DR. WALTER REID : Quite true !

MR. MACARA : Quite true ! I am glad to have that confirmation. And it may be a matter of weeks before the reply is received ; in the interim the trader concerned has fixed up with some rival—probably a road rival. In that connection it is very unfortunate, I think, that the big railway companies—in fact all the railway companies in this country—have never built up adequate reserves. They have all gone in for dividing their profits to far too great an extent, and now in the hour of trial they are caught without those adequate reserves that they ought to have had, and so the hour of trial is very much more serious for them than it would otherwise have been. As a contrast to that, let us take the banks, which have been already referred to by the speakers, and also by Mr. Nelson. There are, of course, criticisms of the banking combine, but we have a great deal still to be thankful for to the Big Five, because they have steadily strengthened their position by reserves and the result is that they have carried through the unprecedentedly difficult times of the last few years without a single bank failure, whereas in the United States there have been hundreds, if not thousands, of failures of banks, with disastrous results. It is a curious thing that in that land of big combines they have never gone in for making their banks big institutions, and they have been caught in this time of stress and trial with a multitude of small individual concerns, unable to withstand the storm. So that, as I say, we have something to be thankful for in the case of our Big Five.

MR. J. STIRLING BROWN, F.C.R.A., F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, it is the proud boast of the accountancy profession that our contribution to the economy in which we live is that of efficient service, and if we are sometimes accused of being unduly cautious I would remind you that caution is the second nature of every accountant and not the monopoly of Scotsmen. I should like to endorse every word that has been said by my friend Mr. Grierson Macara, and Mr. David Allan Hay—both Scotsmen. They have emphasised the fact that big amalgamations and combines fail because they find it impossible to apply the human touch ; consequently the spirit of co-operation and personal interest is absent, and no concern can succeed if it is lacking that spirit. Welfare schemes in many cases are parochial in essence and pauperising in effect. The employees enter into these recreations because they have got to do so, and they are afraid they might lose their jobs if they did not. Furthermore, looking at this

matter from a national standpoint, I am satisfied that if this country were a country of small traders the spirit of confidence would exist between the employer on the one hand and the employee on the other. That spirit can only exist where the concern is relatively small. Then we should find that every man in this country had a stake worth living for, worth fighting for, and it would create that spirit of happiness that has been absent from every country under the sun since 1914. The only time that amalgamation should be considered, in my opinion, is during a time of national stress, such as that of 1914. Consequently, Mr. Chairman and gentlemen, I would strongly suggest to those accountants who are called upon to advise in this matter that they should give their wholehearted support to the movement against future amalgamations, and try to continue the old-fashioned method of a one-man business if possible, or at least a one-man business in spirit and in essence.

THE PRESIDENT: Mr. Chairman, ladies and gentlemen, I would like to pay my personal tribute to the excellence of Mr. Hewetson Nelson's paper, and as the time allotted to me is so short you will forgive me if my remarks are brief.

The movement in the industrial world towards so-called combinations, which is not new, has in some cases known to me proved eminently satisfactory not only to shareholders but to customers, but there are others which have failed in not fulfilling the expectations of their originators. Failure has generally been due to over-capitalisation, shortage of working capital, the merging of units not suitable or necessary for the project as a whole, defects of management and want of efficient control, and in certain cases through change in public taste, loss of markets abroad, and severe competition by imports. Individual businesses, however, are not exempt from many of these risks, and not a few of them have sunk and disappeared as units. I have known of many cases which have proved to be greatly to the advantage of the firms or companies taken over. General conclusions on this subject, as on others, have their dangers, and the old rule usually applies of each case requiring consideration on its merits and being judged by results. That can be the only sure test. I dread, as one speaker has suggested, the further interference of government with trade and commerce. There is enough of that already.

In paragraph 63 of Mr. Nelson's paper an extract is made from the *Incorporated Accountants' Journal* of November 1929, which reads as follows: "When one large company absorbs a number of separate entities, what

were probably a dozen audits by different firms of accountants become one audit by a single firm." I venture to say that this assertion is not wholly justified. In my own experience I have always done my best to persuade directors of large combinations to continue to employ the old auditors of individual units, and often with success, though not always.

THE CHAIRMAN : Ladies and gentlemen, I now have pleasure in calling upon Mr. Hewetson Nelson to reply to the discussion. •

MR. HEWETSON NELSON : Mr. Chairman, my Lord President, ladies and gentlemen, as we have another engagement at seven o'clock it is not my intention to reply in detail upon the discussion. I should like, however, to acknowledge the references which have been made to my paper and to assure all the readers of it that I have appreciated, from the first day that I took my pen in hand to write it, the difficulty and delicacy of the subject with which I was dealing. I have also appreciated the august nature of an International Congress of Accountants, and that that was not the platform from which to utter private sentiments which might be made public in the wrong manner. I have my views upon certain of these aspects. I have seen the problem not merely from the literature I have read but from the practical work of being involved in one of the big mergers, and I still feel that on the whole, taking things on balance and bearing in mind the peculiar times through which we have been passing, the particular phase of the merger has in many cases at any rate served a very useful end.

In conclusion, Mr. Chairman, let me assure my friend from Cardiff that in addition to reading the report of the Committees I trust I have also read, as he will see if he will refer to the bibliography at the end of the paper, his own utterances on the subject, which are in an entirely opposite direction.

Let me conclude, Sir, by acknowledging my personal indebtedness to the speakers and my particular appreciation of the fact that the Lord President of the Congress has spoken in this debate.

THE CHAIRMAN : Ladies and gentlemen, I have to announce that the session will be reopened at 10 o'clock on Friday morning. Nothing remains for me to do but to express my very high appreciation of Mr. Hewetson Nelson's paper, to thank all those who have been so good as to enter into the discussion, and more especially to thank them for the excellent way in which they have adhered to the time limit. If we had only had the same adherence during the day we would have had another hour and a quarter to discuss this very important paper, which has been

written by a man who, I may say, is a past master of the subject. I have very great pleasure indeed in thanking you for your attendance, and I am sure that you will have plenty of good food for thought in Mr. Nelson's paper.

(Adjourned till Friday, 21st July 1933, at 10 a.m.)

• TOUR OF LONDON

The ladies accompanying delegates and visitors were taken in the afternoon on a tour over the eastern part of London, leaving Grosvenor House at 2.30 p.m. The route led through the Strand and Fleet Street to St. Paul's Cathedral, which was visited, and thence via the City to the Tower of London, where the Crown Jewels were inspected. The tour ended with a visit to Messrs. Peter Robinson, Ltd., where 73 ladies were entertained at tea in the Opera Room and shown a fashion parade.

BANQUET IN GUILDHALL

A banquet was held in Guildhall on Wednesday evening by kind permission of the Lord Mayor and Corporation of London. His Royal Highness The Prince George, K.G., was present as the guest of honour. The guests were received by Lord Plender and Sir James Martin in the Picture Gallery ; in number about seven hundred they included, besides delegates, accountants from abroad and members of the sponsoring bodies, many distinguished representatives of the Church and State in Great Britain, as well as of its professions and commerce. The band of His Majesty's Scots Guards played a selection of music during the evening. (For the Programme of the Banquet see Appendix B.)

LORD PLENDER, G.B.E., F.C.A. (President) in the chair.

The loyal toasts having been duly honoured :

H.R.H. THE PRINCE GEORGE, K.G. (who was received with applause) said : Lord Plender, your Grace, your Excellencies, my Lords and gentlemen, I am very pleased to be here this evening to propose the toast of "The Fourth International Congress on Accounting."

International business is not made easier by the difficulties arising from different languages and currencies, but, so far as accountancy is concerned, these difficulties are to a great extent dissipated by the fact that the accounts of nearly all the nations are prepared according to well-tried and universally used principles. That this is so is indicated by the fact that there are here delegates from nineteen different countries.

Anyone wishing to trade with another country would probably find that no difference in principle exists in the way in which accounts are kept.

Although this is the first occasion on which your International Congress has been held in this country, I hope it will not be the last. (Hear, hear.) It does surprise me that this should be only the fourth International Congress of the members of your profession. It seems curious that accountancy should not have been recognised as a definite profession from a much earlier date, similar to the establishment of doctors, lawyers, &c.

From the earliest days of trading, even at the time of the Phœnicians, merchants saw the necessity of keeping accounts, and, what is more important, of having an expert on figures close at hand to explain to them details of their profit or loss on any venture.

At the present time the necessity for good accountancy and of taking the advice of accountants is becoming more and more widely recognised—(hear, hear)—so much so that many companies have an accountant as a member of the Board. It seems to me that an accountant who is employed not as an auditor alone should be regarded as much as a necessity to the directing of the company's activities as a general practitioner is to a large and growing family. The general practitioner watches the family as it grows and warns the parents when the distress signals appear. (Laughter.) Similarly, the duty of the accountant on the Board would be to indicate the treatment necessary if the figures begin to take on an unhealthy appearance in any particular part of the business.

In addition to the helpful services of accountants to companies and businesses generally, it seems obvious to me that the assistance of the accountant to a private individual is becoming more and more of a necessity. Personally, I have my own accounts audited every year in order that I may know where I stand. (Laughter and applause.)

The activities of the accountant cover such a wide sphere that his advice and assistance are indispensable to the commercial man. The high standard demanded to-day can only be achieved as a result of training in order to pass the most searching examinations. Those who contemplate entering your profession may hesitate and ask, "Why should I pass such stiff examinations and then have to wait so long before I can earn a good living?" To those I would say that it must be remembered that the plums of your profession are of a high standard and very remunerative, and should amply repay their hard labours. (Hear, hear.)

A knowledge of accounts is a necessity in every walk of life. So strongly do I feel this that I hope the practice recently instituted of giving a boy a grounding in business methods during the last year of his school life will be considerably extended and that accountancy will fill an important part in this business training. Furthermore, I suggest it is necessary that the teachers make themselves fit for this important part of their work by attending lectures dealing with the practical side of this subject, thus amplifying and perfecting the theoretical knowledge to be gained from text books.

The points I have dealt with are not peculiar to this country ; they apply with equal force to all countries ; and because of this I consider myself privileged to address such a unique gathering of those practising the age-old and honoured profession of accountancy.

In conclusion, I wish every success to the Fourth International Congress on Accounting, and I hope that by discussing your various problems in a spirit of mutual co-operation lasting benefit will result, not only to yourselves personally, but to all the countries which you represent.

Now, gentlemen, I will ask you to rise with me to drink to the health of the Fourth International Congress on Accounting, coupled with the names of your Chairman, Lord Plender, and Colonel Montgomery. (Applause.)

(The toast was duly honoured.)

THE PRESIDENT (who was received with applause) said : Your Royal Highness, your Grace, your Excellencies, my Lords and gentlemen, the recognition of the value of a professional accountant's work and influence is universally accepted, and your Royal Highness's confirmation of this fact gives pleasure and satisfaction to this large and representative gathering of delegates and visitors from many nations.

There are few countries in the world where our services are not available and made use of, and as each year passes such services become more and more part of a country's industrial, commercial and financial life. Legislation here affecting limited liability companies compels the employment of auditors ; but this statutory obligation is not yet common to countries outside the British Empire, and the hope of many delegates present is that compulsory annual audits of public companies and of corporations, as they are sometimes called, will be regarded as a desirable necessity by their own Governments.

The International Congress now sitting aims at securing a free exchange of experience and opinions on many of the problems in accountancy

which have not only a relation to practice in this country, but have international characteristics. They cannot, however, be wholly standardised, as laws of nations and judicial dicta affecting accounts and auditors differ, and the scope of their duties in the countries of the world with different conceptions of duty and responsibility do not correspond. But there are points of resemblance, and, as far as is practically possible, uniformity in main principles should be aimed at. The ruling idea ought to be to state facts as closely as they are ascertainable, and this end is what we all seek to accomplish ; but sometimes the road to attainment is strewn with impediments and the finish is not easy to reach.

It may interest your Royal Highness to know that the eight sponsoring bodies responsible for convening the Congress have a membership of 25,000 and there are other important bodies in this country the membership of which numbers some thousands, such as the Institute of Municipal Treasurers and Accountants, the Institute of Cost and Works Accountants, and the Institute of Bookkeepers, whose functions bear a relationship to public accountancy. We do not know the membership of all the organised accountant societies throughout the British Empire overseas, the United States of America, the Continent of Europe, and the Far East, but there must also be very many thousands of them.

There is, as your Royal Highness has observed, hardly any section of the community that does not requisition our services ; and every Government in Great Britain, whatever its political complexion may be, seeks our aid in appointing members of our Institutes and Societies to serve on Royal Commissions, Departmental Committees, and also in other less public ways. This is a testimony to our usefulness and a recognition of our help which we greatly appreciate.

This is not the time or the place to enter into all the classes of work which fall to us to undertake ; but they are surprisingly varied from the birth to the burial of companies and from their resurrection to a new and enlarged life ; but the illustrations which your Royal Highness has given are typical of the comprehensive nature of the duties we fulfil. No profession offers more possibilities of useful public service—often onerous and carrying heavy responsibilities, but always of absorbing interest and not seldom illuminating in their disclosures.

Rapid as has been our growth in recent years, the profession continues to enlarge year by year, notwithstanding the severity of examinations before membership can be secured, and we have far from reached the limits of its possibilities, which increase as business becomes more intricate

and specialised, as case law relating to income-tax extends, as problems arise affecting accounts of subsidiary companies, as capital structures of companies in distress need revision, and as exchange disturbances and restrictions affect the results of trading.

We know how critically our work is regarded and how much our reputation is dependent on its reliability, and how character counts as in all other walks of life ; but, stimulated by your Royal Highness's words and fortified by the confidence of clients and the public, we shall strive not to be undeserving of that confidence.

We meet to-night in the Guildhall by the courtesy of the Lord Mayor and Corporation of the City of London—(applause)—and to the delegates and visitors from overseas this ancient hall with its wonderful memories and its stately monuments must give to them, as it always gives to the citizens of London, a feeling of continuity, of pride, and of inspiration. The nations of the world, of whom there are many representatives present, need to-day more than ever to approach to closer friendly relations, a kinship of motives, and a common purpose that is not bounded by geographical limits. The contacts of men from all countries should help to harmonise conflicting views, leading to a closer and a better understanding, and, in so far as our own profession is concerned, the Congress now sitting will not be found wanting.

When our visitors return to their own countries after a week of effort which the uninitiated public might regard as almost sepulchral in its dullness—though relieved at times by spasms of restrained gaiety—we hope they will regard us with tolerance which our natural modesty forbids us to magnify into hero-worship, and that, after all, we as a people with all our faults have a little genius for friendship. Experience has disciplined us. The past with its successes and its mistakes lies behind ; but whatever our failures may have been we can with modesty say that we have tried to be loyal to the aims and objects which were the guiding principles of those who founded the several institutes and societies throughout the world to which we belong. The story of the future is untold, but when it is unfolded in years to come we of to-day hope that it will be a story of services still more extended, of high purposes fulfilled, and of ideals realised.

We thank your Royal Highness for the great honour you have paid us and for your words of encouragement and good wishes for the success of the Fourth International Congress on Accounting, and we assure your Royal Highness that your visit to-night will long be gratefully remembered by all of us. (Applause.)

COLONEL R. H. MONTGOMERY (who was received with applause), in responding to the toast, said : My Lord Chairman, your Royal Highness, your Grace, your Excellencies, my Lords and gentlemen, before leaving America I heard it whispered around that the word " debts " was to be tabooed while in Europe. Your Royal Highness may not know it, but accountants are quite used to ignoring instructions, and I am tempted to ignore this admonition, and transgress, if you will. But the debts I want to mention are debts of gratitude—(laughter)—gratitude to our hosts, our British accounting brethren, for the deep-rooted and sound fundamentals of accounting theory, practice and ethics we have inherited from them ; to your Royal Highness for your kind and generous welcome ; and to you, Lord Plender, for this festive gathering here to-night. I am deeply sensible of the honour which has been accorded in permitting us to gather in this historic hall, rich with its atmosphere of traditions, and in being greeted by some of Britain's foremost sons. It is a proud day for accountants. When we again cross the seas and return to our homes we shall carry with us a memory which time will not erase, and one which will symbolise the international good fellowship and friendly co-operative spirit so manifest here to-night.

Four years ago it was my privilege to welcome the delegates to the Third International Congress on Accounting held in New York. At that time we were riding on the crest of the wave of success, which has now receded into the far distance, leaving us upon a different level. This four years period has been one of stress and strain for most of us, while the world has been seeking a means of recovery from its economic ills. We have had new lessons to learn, and in the process it has also been necessary to unlearn not a few of the old ones. The tracks through the wilderness of financial and industrial uncertainties which the accountant has been required to chart have increased tremendously in number and in character of terrain. His responsibilities now embrace fields not hitherto envisioned.

To face successfully these new conditions we now and again need time for meditation in order that we may retrace our steps back to the fundamental theories of accountancy and make sure that our newly-trodden ways have not become so devious as to obscure the pivotal starting point. We could have no better opportunity for such meditation than is now presented by this Fourth International Congress. We are assembled here in the country in which the practice of accountancy was first developed and where it first attained widespread and respected standing. In such

an atmosphere and amid such traditions our deliberations will be carried on under the most favourable and happy auspices.

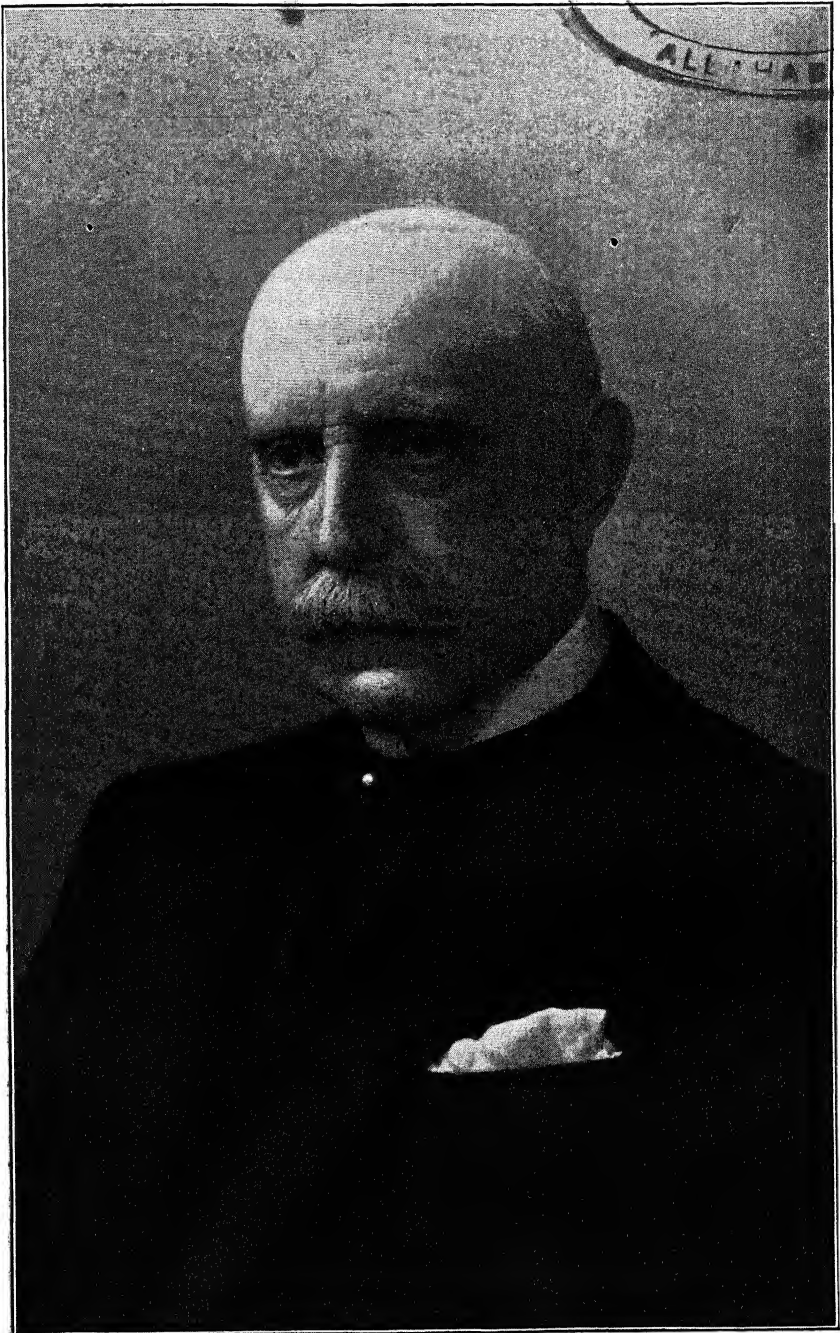
It is an honour, a privilege, and a pleasure to attend this Fourth International Congress on Accounting. I had some part in the first Congress in St. Louis in 1904 ; in Amsterdam in 1926, and in New York in 1929. Not one of them would have been a success had it not been for the British attendance and participation. When we very properly speak of the 1904 Congress held in St. Louis as the First International Congress on Accounting we must not forget that it was a British accountant—George Wilkinson—who first thought of it, who organised it, and who made it a success. Perhaps he was influenced by the land of his adoption, but those of us who knew and loved him well recall that he never lost his pride in British traditions which he so well exemplified. In the years immediately following, Sir Arthur Dickinson was a tower of strength in directing the ethics and practice. He is here this evening. (Applause.)

I am not sure that in St. Louis and in New York the British delegates always wanted to attend the almost continuous and highly technical sessions usually held in terrifically hot weather (and they always wore too many clothes), but they were such thoroughly good sports that they never dreamt of letting their hosts down. Their energy and interest were unbounded. They discussed every subject. They were always sure that they were right, and sometimes they were ! I am afraid that the delegates and visitors at this Congress will not do half so well, but we do not have their reputation to sustain.

I have come to the conclusion that a nation is great in direct proportion to the number of professional accountants within its borders. Go to any place you like in the world, and there you will find the British accountant. Visit England, and you will find him represented in all that has made Britain great. And this goes on even though you have a most terrible climate and you wear too many clothes in hot weather.

There may be an over-production of pretty much everything throughout the world, but there has been no over-production of professional accountants in England or in the United States.

It is not surprising that the World Economic Conference is about to adjourn. Their problems, national and international, as they saw them, were insoluble, but they would have been more nearly solved if accountants had been permitted to resolve all questions into debit and credit. England would be proud of the result. You have more and bigger credits than you have debits. Your debits are so few and so small that we hardly



[Photo by Vandyk

THE HON. GEORGE COLVILLE, M.B.E.
Secretary of the Congress

bother to mention them. Although I should refer to the corrections you made in the spelling of some of the words in our papers, I am sure that you are wrong, but all I did was to moan softly to myself and let it go at that. The balance of these debits and credits in your favour would be so large that it would astonish you, even though you have an extremely good opinion of yourselves !

Internationalists are not popular to-day. Trade and race barriers and prejudices are being built up faster than they are being torn down. Accountants have had no part in their building up ; they would like to have a part in the tearing down. They could settle the question of currencies, tariffs, war debts, and reparations by again applying their inexorable principles of debit and credit. It is hardly necessary to prophesy how England would come out in the balance. You would not need to have a single British accountant to make, nor to audit, the entries. You could choose the accountants by lot from any country in the world, and the result would be the same. The honour and the integrity of the British nation, as carried round the globe by the British accountant, have left an indelible impression of fairness, honesty and righteousness, and as you have dealt with others so others will deal with you.

All over the world the British accountant has been found—and for what purpose ? It has been to seek the truth, and when it is known that what you want is the truth, the whole truth, and nothing but the truth, the seeker of the truth justly acquires a reputation for fair play and honesty in his dealings with his fellow men.

This truth I have referred to has dealt chiefly with production, distribution and consumption of tangible rather than intangible things ; but when the British went on decade after decade striving to ascertain nothing but the truth in respect of tangible things, it becomes easy to understand why it is that in what we call the finer things of life—religion, the arts, sciences, politics—the British have sought and still seek the truth. They do not believe that any living man has a monopoly of brains or genius, but that the human race is still so fallible that we must keep on seeking the truth about every subject until we find it, and that in the meantime we must have open minds.

I have said that all over the world you find the British accountant. You can always tell a British accountant, but you can't tell him much !

May the British accountants continue to carry the proud banner of Britain throughout the globe and continue to give us, who live in better climates and who wear fewer clothes in the summer-time, an example

of high thinking at all times, courage when it is most needed, and friendship which is as genuine and as tight and as right as your little island has been and always will be.

We thank you for your cordial greetings and for your boundless hospitality. Our respect and affection for British accountants, which needed no acceleration, nevertheless has been broadened and strengthened. We hope to come again. (Applause.)

THE VICE-PRESIDENT (who was received with applause), said: Your Royal Highness, your Grace, your Excellencies, my Lords and gentlemen, I think I am somewhat entitled to your sympathy, because whatever I have to say is limited to the Fourth International Congress on Accounting, and you have already heard on this subject His Royal Highness, my Lord in the chair, and Colonel Montgomery; but I am cheered by this fact, that, on behalf of the sponsors of the Fourth International Congress on Accounting in England and Wales, in Scotland, and in Ireland, I have both the honour and the pleasure of submitting for your cordial acceptance the toast of "The Guests." (Applause.)

Twenty-nine years have passed since, on a very hot September night, at St. Louis, U.S.A., I responded with a valued English colleague to a similar toast, which I recollect was drunk with enthusiasm, somewhere about two o'clock in the morning. Of those who were at that, the first international gathering of accountants, eight are here to-night, two as hosts and six as guests. With the name of one of the latter I propose in a few moments to associate the toast. At the banquet of 1904 there were 119 hosts and guests, including ladies. Here to-night we number about 700, but, alas! the ladies are absent, as even this Guildhall could not accommodate all who desired to be present.

As one of the senior citizens of this great City, it is a great joy to me that the Lord Mayor and Corporation have so kindly and graciously allowed us to gather here on this interesting occasion. Although this historic building cannot claim a longer record than five hundred years, it is a fact that the site of the ancient Guildhall on the land adjoining has been consecrated to civic government for more than a thousand years. It is here that English liberty has been gradually evolved by the citizens, and it is here that we shall ever protect the inheritance of which we are so proud. (Applause.)

Our guests to-night must be divided into two sections—those who from twenty-three countries, including the overseas Dominions of the British Empire, have accepted our invitation to come to Great Britain and

Ireland, and those distinguished in every walk of life, headed by His Royal Highness, who have honoured the accountants of the world by coming here to meet and welcome them. Among these distinguished men is His Grace the Lord Archbishop of York. (Applause.) That beautiful service which was held in Westminster Abbey at the opening of the Congress, by the kind permission of the Dean, reminded us that we accountants are the custodians of the great principles of mutual trust. All of us will be glad of the opportunity of hearing His Grace respond to this toast.

For our guests from other lands I am going to ask my friend of twenty-nine years' standing, Mr. E. Van Dien of Holland, to reply. Mr. Van Dien was, as I have already indicated, a delegate to the First International Congress, and the President of the Second Congress, held in Amsterdam.

To all those who have come to our shores I desire to express our earnest wish in ancient language : " Peace be within thy walls, and plenteousness within thy palaces. For my brethren and companions' sakes, I will wish thee prosperity." (Applause.)

HIS GRACE THE ARCHBISHOP OF YORK, P.C. (who was received with applause), replying to the toast, said : My Lord President, your Royal Highness, your Excellencies, my Lords and gentlemen, those who have had the arrangement of the programme of this Congress have indeed conferred upon me a very signal honour. Not only was I allowed to speak at that most impressive service in Westminster Abbey, to which allusion has just been made, but you have singled me out—and you will shortly discover how appropriately—to reply to the toast on behalf of the guests on this occasion ; at least, for those of them who reside in these islands ; appropriately, because I am indeed one of those whose financial state needs careful watching. (Laughter.) I do not know what may be the condition of His Royal Highness's accounts when the accountant to whom he refers presents his report ; but I know that my own way of doing my accounts is to add them up and then to add them down, and then to take the difference between the two results. (Laughter.) That I find to come near enough for all practical purposes—(laughter)—until I receive further information from a banker or someone else learned in the low arts of arithmetic.

On that other occasion I ventured to refer to accountants as the custodians of the mutual trust and of the integrity of industry and commerce, a most sacred function and a function rendered all the more important and in some respects all the more difficult by a paradox which

is inherent in the nature of industry and commerce—I mean that the method, at any rate as we are familiar with it, is in a high degree competitive, and it must appear very often to those who are engaged in these occupations that they are engaged in a perpetual attempt to get the better of someone else if they can—(laughter)—whereas they know quite well in their hearts that industry and commerce only flourish when the benefit of all parties concerned is really served. (Hear, hear.) Commerce does not prosper when one of the partners to a transaction secures a benefit at the cost of the other. It flourishes only when there is a benefit to both partners as the result of their mutual transactions. (Hear, hear.) And the same thing is true of industry, with the financial aspects of which you are so intimately concerned. Our reformers sometimes tell us that there ought to be public services, co-operative schemes, conducted for the public benefit, but it never is anything else. People may practice, as it were, something else, but it can never be anything else ; it only exists to serve the public ; for it is only if the public wants its produce that it can go on at all, and it can only go on so long as the various factors within it are co-operating with one another. The fact is, of course, that these two apparently alien principles of competition and co-operation can be wrapped up in one another to any extent you like.

Our visitors from overseas are aware that in this country we are much addicted to games that are played between teams. I will not say anything of the main summer occupation of our islanders, because my views on that subject would be unpopular. (Laughter.) I have a feeling that if only it had been developed on the principles of tip and run, cricket once had the makings of a game. (Laughter.) But as that great opportunity was neglected it has developed into an occupation. (Renewed laughter.) There is a game we play in winter called football, and if it were the kind of game that it ought to be there would be thirty players—(laughter)—all of whom are co-operating for the fun of the game ; and the way that they have co-operated for the fun of the game is for fifteen of them to compete against the other fifteen, while at the same time each individual is competing with his fellow members of the team to be the best co-operator in the process of competition for the sake of the game. (Laughter.)

I want to submit to you that if you can wrap up these principles with one another, like that in a mere game, you need not suppose that anything as complicated as industry or commerce has got to be either purely competitive or purely co-operative ; it is likely to be done on a large scale ;

but in the case of the game it makes all the difference in the world which is uppermost ; because if the co-operative spirit is uppermost you are a good sportsman who would rather be defeated in a good game than win a walkover ; whereas if the competitive spirit gets uppermost you get the kind of team who play only to win, and who will do any dirty trick that the referee will let them. (Laughter.)

One of your great functions is to set a limit beyond which those who have not got the co-operative spirit in industry and commerce shall not be allowed to step, so that the whole credit of the structure of these great human activities may not be imperilled. But even where players are good sportsmen the referee is still wanted, for it is impossible for those who are engaged in the process of the game always to see perfectly well when the rules are being kept, even though there is the utmost intention to keep them, and a player may very well be off side without knowing it. (Laughter.)

Well, it is in some such way as that that those of us who are outside your mysteries and do our own accounts, in the way which I have already described as my own habit, regard your functions in the civilised world, and, consequently, our gratitude, which is most sincere for your hospitality this evening, is mingled with the gratitude for a profound service to the welfare of mankind. (Applause.)

MONS. E. VAN DIEN (who was received with applause) said : My Lord President, your Royal Highness, your Grace, your Excellencies, my Lords and gentlemen, I am much honoured by the invitation to answer to the toast of " The Guests," and I thank Sir James for the friendly manner in which he has introduced my name in this connection.

It is very difficult, especially for a foreigner, to find new adjectives to express the admiration we all have for the manner in which British colleagues entertain their guests. I therefore might be allowed to tell you something like a fairytale that happened to me during this Congress. I have the great favour to have my wife with me during these days, and, as a matter of course, one of the subjects we discuss is : What dress she should wear at the different festivities she is invited to attend. We always agree in these matters, as she always wears the dress *she* thinks fit. Now, on one occasion it was agreed that she was going to wear a black dress, that she would put on some flowers, and it was agreed that it would be pink carnations ; and at the moment that I went to the telephone to order the carnations there was a knock at the door, and a boy brought a box for Mrs. Van Dien, containing pink carnations with the

compliments of the Executive Committee. Now, the only thing that we said to each other was : " This is like a fairy-tale ! It is quite British ! They don't say much, but they do, and they do excellently."

May I once more thank you in the name of the guests and for myself for the splendid entertainment of this evening, and for the opportunity you give me to express these thanks.

I finish with the words of my friend Montgomery : We hope to come again. (Applause.)

" THE CHAIRMAN "

THE MARQUIS OF READING, P.C., G.C.B., G.C.S.I., G.C.I.E., G.C.V.O. (who was received with applause, said : Your Royal Highness, your Grace, your Excellencies, my Lords and gentlemen, you have had a series of excellent speeches, and the only excuse that I offer for making a speech at this moment is that it is to propose a toast which I am perfectly certain will be received by you with acclamation, and that is the toast of your President, Lord Plender. (Applause.) Good wine needs no bush, we learn. I saw it quite recently corrected by the Prime Minister, who told us that good wine needs good bush ; but then he was speaking at an advertising convention. (Laughter.)

In this society, amongst all of you, it is really hardly necessary for me to say a word about Lord Plender. I have had a long friendship with him. A long association over many years in different capacities impels me just to keep you for some three or four minutes, and no more, at this time of night. I thought I knew much of what Lord Plender had done during his very busy life, but I looked in " Who's Who," as some of you may have done when you have had the honour of proposing a toast, and I found such a record that I was absolutely staggered. I knew much of what Lord Plender had done, but I certainly had no conception of the many posts that he had filled, both international and national. This I did know, that he stands very high in the estimation of his country. (Applause.) His position in the world of accountancy is illustrated by his presence here this evening by his Presidency over this great Congress.

I was glad indeed to learn from him during his speech that this Congress with all its difficulties, is going to prove successful. That is not always the fate of International Conventions. (Laughter.) We are glad that at this moment this Conference is successful, as it was almost certain to be with Lord Plender at its head.

I have listened to-night to much which has been said about the profession of accountancy, and especially from your Royal Highness when

you said that, in these days particularly, it is so eminently desirable that our young men should have the opportunity of studying and of obtaining at least some knowledge of accountancy. As to whether to debit an item to capital or revenue, whether it should be debited to obsolescence, or whether it should be brought in as a special expenditure on maintenance; as to whether an item could properly be carried to suspense account and written off during a number of years instead of being taken straight away from the revenue account of that year—(laughter)—all those are questions into which we will not enter to-night; but, my Lord Plender, may I say, after a very long experience of your profession and of you, an experience in various capacities which I have had to fill, I feel that it is on the integrity of purpose of accountants, the character of the men, that we depend for the confidence that we place in our accountants and the trust that is generally reposed in them. I know very well the kind of pressure and arguments that may sometimes be used, particularly in difficult years, when the balance sheet comes to be drawn up; but the accountant who is worthy of his profession stands firm, resists the arguments and withstands the pressure if he is convinced that he is right, and, notwithstanding all that may happen, insists upon stating the truth in his certificate. That is the reason why accountancy stands so high with us.

And now, my Lord President, I must say no more about you, because I was fully determined that I would not keep you here until two o'clock to-morrow morning, as was evidently the case at one assembly of this kind, but that I should content myself with making just these few observations, conscious as I am of the pleasure that we all feel in drinking to the health of him who was distinguished only, I think, some two years ago by His Majesty the King by being raised to the Peerage as a mark of appreciation of his public services during his life and of the character which he had displayed throughout.

I give you the toast of Lord Plender. (Applause.)

(The toast was duly honoured.)

THE PRESIDENT, in reply, said: The noble Marquis in proposing my health has shown that kindness of heart in his references to me which is so characteristic of his generous nature. I shall long remember his words to-night, and I thank him, as an old friend, for all he has said, and I also thank this great audience, drawn from many countries, for the warm reception given to the toast.

Whilst at the Bar and throughout his long and devoted life to the in-

terests of his country, Lord Reading has always been ready to recognise the little efforts which others make in public service and for their profession, and to overlook their shortcomings, which in my case are many.

He belongs to that great profession of the law—the guardians of liberty—whose members are among our best friends. There is a Common Law upon which has been built the structure which holds for the English-speaking races a conception of justice that nothing can shatter, and there is a law of nations which Justinian says is that which natural reason appoints for all mankind because all mankind uses it. There should be no boundary between nations in a common devotion to right, and in our profession, as in the law, there are principles which everyone engaged in its pursuit the world over should observe in trying to arrive at truth. We all have some ideal to guide us, some goal we wish to reach, and if we strive and seek, we shall find. (Applause.)

THURSDAY, 20th JULY, 1933

SOCIAL EVENTS

Lord and Lady Plender's Garden Party

Visit to Windsor Castle

Visit to Hampton Court Palace

Visit to the Port of London

Visits to Oxford and Cambridge

Golf Competition

Private Dinner Parties

SOCIAL EVENTS

There were no Congress Sessions on Thursday, which was devoted to the social side of the programme. All members of the Congress were given a choice of a number of excursions, of which a brief report follows.

LORD AND LADY PLENDER'S GARDEN PARTY

Lord and Lady Plender gave a Garden Party at their country house at Ovenden, Sundridge, Kent, from 3.30 p.m. to 6 p.m. About 250 guests, who travelled down either by motor coach or private car, were received by their host and Lady Plender on the lawn immediately in front of the house. The band of the Royal Air Force played during the afternoon and the guests had an opportunity of viewing the grounds, including the typical English flower and rock gardens.

VISIT TO WINDSOR CASTLE

A special train left Paddington at 9.5 a.m., taking a party of about 150 to Windsor, where they arrived soon after 9.30 a.m. They walked from the station to the Castle, where they were shown over the State Apartments. The return to London was made by special train, and the party proceeded, on their arrival at 12.20 p.m., to Grosvenor House for luncheon, at which Councillor F. Wilson, J.P., F.C.R.A., presided.

VISIT TO HAMPTON COURT PALACE

The visit to Hampton Court Palace was made by a party of 45, who journeyed there by motor coach from Grosvenor House. On arrival the visitors were shown over the Palace and grounds, and those who wished were able to inspect the Royal apartments. Luncheon was served at Hatchett's, when Mr. Percy H. Walker, F.S.A.A., presided.

VISIT TO THE PORT OF LONDON

A party of about a hundred selected the trip down the Thames. They were fortunate in being accompanied by Mr. Haworth, chief accountant to the Port of London Authority, and by Mr. E. K. Holmes, assistant

publicity officer, and the journey was made on the S.S. "St. Katharine," kindly lent for the occasion by the Port of London Authority. Starting from Tower Pier at 9.45 a.m., the S.S. "St. Katharine" proceeded down the river to Tilbury, where the company disembarked for luncheon at the Tilbury Hotel, after inspecting the Baggage Hall. Mr. John Myers, F.C.A., presided, and expressed the thanks of the company to the Port of London Authority for the excellent arrangements made. Mr. Haworth replied briefly.

The return journey commenced about 2.15 p.m. and during its course a visit was paid to the King George V, the Royal Albert and the Royal Victoria Docks, which comprise the largest sheet of enclosed dock water in the world (245 acres), and provide twelve and three-quarter miles of quays. Tea was served on board and the trip ended at Tower Pier at 6.15 p.m.

VISITS TO OXFORD AND CAMBRIDGE

Parties of approximately 60 visited Oxford and Cambridge, travelling in each case from London by train. At Oxford visits were paid to Magdalen College, also to St. John's College, the Sheldonian Theatre, the Bodleian Library and St. Mary's Church before luncheon, which was served in the Hall of New College by kind permission of the Warden and Fellows. Dr. Walter Reid, C.A., F.F.A., presided. After luncheon, motor coaches again conveyed the visitors to other Colleges. Tea was served on the train during the return journey to London.

At Cambridge, Peterhouse was first visited, and afterwards King's College, the Senate House, Clare College and Trinity Hall. Mr. W. Bertram Nelson, A.S.A.A., presided at luncheon, which was served in Trinity College by kind permission of the Master and Fellows. A drive round Cambridge completed the programme, and the party then took train for London, on which tea was provided.

GOLF COMPETITION

A golf competition was held at Moor Park (by the courtesy of Moor Park Golf Club), for which 71 entries were received. The Medal Competition was played on the High Course, and the Bogey Competition on the West Course.

In the Medal Competition, Mr. K. N. Graham, playing from a handicap of eleven, returned the net score of 69 to win first prize, being one stroke better than Mr. A. K. Gibbs who, playing from fourteen, had a net score of 70.

Mr. Eric Dexter and Mr. R. S. Mays-Smith both returned 77 gross, which constituted the best score of the day for the Scratch Prize. Mr. Mays-Smith had a score of 39 over the first nine holes against Mr. Dexter's 41 and was, therefore, awarded the prize. Mr. Eric Dexter won the prize for the lowest net score over the last nine holes.

In the bogey competition, Mr. Andrew Stewart, who was a delegate from U.S.A., played excellent golf from a handicap of ten and returned eight up on bogey, having used only four of his strokes in the round. This score easily won the first prize and the runners-up were Mr. C. Browning and Mr. C. E. M. Emmerson, who both returned two up. The latter had the best return over the first fourteen holes and took second prize.

The prizes, the gift of Lord Plender, were presented to the winners by Lady Plender at the Ball on Friday evening.

PRIVATE DINNER PARTIES

Members of the Executive Committee and others entertained delegates and visiting accountants with their ladies at dinner in the evening. The following invitations were issued :—

By LORD AND LADY PLENDER	By MR. AND MRS. R. WILSON
Colonel and Mrs. R. H. Montgomery (U.S.A.)	BARTLETT
Mr. and Mrs. Andrew Stewart (U.S.A.)	Mr. and Mrs. J. Berg (U.S.A.)
	Mr. and Mrs. H. R. Clark (Canada)
	Comm. Dott. Alfredo Selvi (Italy)
Mr. and Mrs. J. Parton and Miss Parton (Canada)	By MR. AND MRS. HAROLD BARTON
Herr Dr. W. Voss (Germany)	Mr. and Mrs. G. S. Olive (U.S.A.)
M. and Mme. G. W. Frese (Holland)	M. and Mme. O. Breuner (Denmark)
	M. and Mme. R. Martin (France)
By SIR JAMES AND LADY MARTIN	By HON. GEORGE AND LADY CYNTHIA COLVILLE
Mr. and Mrs. John Hyde (Canada)	Herr and Frau. H. W. Mueller (Germany)
Mr. and Mrs. John W. Ross (Canada)	M. and Mme. J. P. Strobel (Denmark)
M. and Mme. E. Van Dien (Holland)	M. and Mme. M. Barbut (France)
M. M. Tolfsby (Norway)	M. H. Sénéchal (France)
Mr. C. B. Martin (South Africa)	M. and Mme. E. Thorsen (Norway)
M. le Capitaine K. Haanes (Norway)	Miss Kathryn Sagal (U.S.A.)

By MR. AND MRS. A. E. CUTFORTH

Mr. A. L. Crampton Chalk (Canada)
 Herr M. Schwoon (Germany)
 Señor R. Casas Alatraste (Mexico)
 Mr. J. F. Welch (U.S.A.)
 Mr. Welch, Junr. (U.S.A.)
 Mr. and Mrs. R. K. Hardy (Great Britain)
 Fräulein J. Schmidt (Germany)
 Mr. A. J. Walker (Canada)
 Sig. Francesco Solitti (Italy)

By MR. AND MRS. E. CASSLETON
 ELLIOTT

Mr. and Mrs. J. F. Forbes (U.S.A.)
 Mr. and Mrs. J. G. Carter (South Africa)
 Mr. H. W. Buckingham (Great Britain)
 Miss Joan M. Elliott
 Mr. D. M. Muir (Great Britain)
 Herr W. Duering (Germany)
 M. le Drs. A. Robles (Holland)
 Miss Rutherford Williamson (Canada)

By MR. AND MRS. A. A. GARRETT

M. and Mme. P. Drăgănescu Brates (Roumania)
 Dr. K. Fujimoto (Japan)
 Herr Dr. Egon Singer (Germany)

By MR. AND MRS. H. L. H. HILL

Mr. and Mrs. A. S. Banks (U.S.A.)
 Miss Banks (U.S.A.)
 Mr. M. O. Haskell (Canada)
 M. A. Roche (France)
 M. and Mme. R. A. Dijker (Holland)
 M. Dijker, Junr. (Holland)
 M. O. Jelf (Sweden)
 M. C. De Regt (Holland)

By MR. AND MRS. H. G. HOWITT

M. and Mme. H. Andersen (Denmark)
 M. Capitaine Løkkegaard (Denmark)
 M. and Mme. R. Jollet (France)
 Mr. E. H. Griswold (U.S.A.)
 M. and Mme. A. Holban (Roumania)
 M. and Mme. L. Retail (France)

By MR. AND MRS. THOMAS KEENS

Mr. A. F. Fedde (U.S.A.)
 M. and Mme. C. Jespersen (Denmark)
 M. L. T. Bohlin and Mlle. Bohlin (Sweden)
 Mr. Edward Marriott (Australia)
 Herr Dr. W. Schiffmann (Germany)

By MR. AND MRS. HAROLD F. KEMP
 & MR. WILLIAM CASH

Mr. and Mrs. Maurice E. Peloubet (U.S.A.)
 Mr. and Mrs. W. A. Staub and Miss Staub (U.S.A.)
 M. K. Augsten (Czechoslovakia)
 Herr G. Schulze (Germany)
 M. le Prof. G. L. Trancu Iasy (Roumania)
 M. T. Sjoaker (Sweden)
 M. and Mme. C. Sommerschild (Norway)
 Mr. W. H. Stalker (Great Britain)
 Mr. and Mrs. R. Wynne Bankes
 Mr. D. A. R. Kemp

By SIR BASIL AND LADY MAYHEW

Mr. and Mrs. H. A. Hatfield (U.S.A.)
 M. S. Wojciechowski (Poland)
 M. and Mme. J. Polak (Holland)
 Mr. H. Jackson (Roumania)

By MR. AND MRS. HENRY MORGAN
 Mr. and Mrs. A. C. Upleger (U.S.A.)
 Miss Upleger (U.S.A.)
 M. and Mme. P. Klijnveld (Holland)
 Herr Dr. G. F. Horn (Germany)
 Mr. and Mrs. Rutherford William-
 son (Canada)
 Mr. J. R. W. Alexander

By MR. AND MRS. CHARLES REID
 Mr. and Mrs. R. H. Butler (Aus-
 tralia)

By MR. AND MRS. R. STANLEY
 STOKES & MR. AND MRS. A. H. MUIR
 M. R. Bès de Berc (France)
 M. and Mme. E. Buriat (France)
 M. and Mme. D. N. Butculescu
 (Roumania)
 Mr. and Mrs. E. E. Mills (Great
 Britain)
 M. S. Ștefănescu (Roumania)
 Mr., Mrs. and Miss Rittenhouse
 (U.S.A.)

By SIR NICHOLAS AND LADY
 WATERHOUSE
 Mr. and Mrs. D. Himmelblau
 (U.S.A.)
 Lieut.-Col. H. D. Lockhart Gordon
 and Mrs. Gordon (Canada)
 Herr K. Fritz Spohn (Austria)
 M. W. T. J. Abbema (Holland)
 M. K. Elfborg and Miss Jean Gibson
 (Sweden)

By MR. F. WILSON
 Herr Curt Täubert (Germany)
 Señor and Señora A. Chavero
 (Mexico)
 Señor J. Ibarrola (Mexico)
 Mr. and Mrs. F. W. Sharp (Canada)
 Herr Hans Weickert (Germany)
 Herr Reinold Weickert (Germany)

FRIDAY, 21st JULY, 1933

Morning Session

CHAIRMAN: MR. H. L. H. HILL, F.C.A. (*President of the Institute of Chartered Accountants in England and Wales*).

HONORARY CHAIRMAN: MONS. HONORÉ SÉNÉCHAL (France).

PAPERS

“The Auditor’s Responsibility in Relation to Balance Sheets and Profit and Loss Accounts”

From the British Point of View

MR. HENRY MORGAN, F.S.A.A.

From the Continental Point of View

DR. WILHELM VOSS

From the American Point of View

COL. ROBERT H. MONTGOMERY, C.P.A.



MR. H. L. H. HILL, M.A., F.C.A.
*President of
The Institute of Chartered Accountants in England and Wales*

[Photo by Elliott & Fry]

THE AUDITOR'S RESPONSIBILITY IN RELATION TO BALANCE SHEETS AND PROFIT AND LOSS ACCOUNTS

THE BRITISH POINT OF VIEW

BY

HENRY MORGAN, F.S.A.A.

The accountancy profession in Great Britain has developed rapidly this century in the scope of its activities and the extent of its responsibilities. There is, however, no aspect of the professional accountant's work which carries heavier responsibility and presents greater difficulties than his duties as auditor of joint-stock companies. There has been an enormous expansion in joint-stock company practice during the last thirty years, as is demonstrated by the great increase in the number of companies and shareholders. There exists to-day a far larger number of great industrial and commercial combinations, with tens of thousands of shareholders, and this, coupled with the rapid extension of the holding and subsidiary company principle, has further increased the difficulties of auditors of public companies.

COMPANIES ACT, 1862 : OPTIONAL ACCOUNT AND AUDIT PROVISIONS

Under the Companies Act of 1862, which applied to Great Britain and Ireland, it was not obligatory for a company to appoint an auditor, and the Act contained no clauses as to balance sheets, accounts or audit, except the optional provisions concerning accounts and audit in Table "A," being the First Schedule to the Act. Although any company could thus reject any or all of such provisions, it was customary for companies of any size or importance to provide by their regulations for the appointment of auditors, the audit of their accounts and the certification of their balance sheets. The auditor's duties at that time were set out in Clauses 83, 92 and 94 of

Table "A," which read as follows, and may be regarded as having been based upon correct practice :—

(83) Once at the least in every year the accounts of the company shall be examined, and the correctness of the balance sheet ascertained, by one or more auditor or auditors.

(92) Every auditor shall be supplied with a copy of the balance sheet, and it shall be his duty to examine the same, with the accounts and vouchers relating thereto.

(94) The auditors shall make a report to the members upon the balance sheet and accounts, and in every such report they shall state whether, in their opinion, the balance sheet is a full and fair balance sheet containing the particulars required by these regulations, and properly drawn up so as to exhibit a true and correct view of the state of the company's affairs and in case they have called for explanations or information from the directors, whether such explanations or information have been given by the directors, and whether they have been satisfactory ; and such report shall be read, together with the report of the directors, at the ordinary meeting.

COMPANIES ACT, 1879 : PROVISIONS FOR AUDIT OF ACCOUNTS OF BANKING COMPANIES

The Companies Act of 1879 contained provisions relating to the audit of the accounts of banking companies. With this restricted exception, no Companies Act until the year 1900 contained obligatory provisions as to balance sheets, accounts or audit. Between the years 1879-1900 however, a number of important cases came before the Courts relating to the duties, obligations and responsibilities of auditors. The judgments given went far to settle the principles by which auditors should be guided and their actions judged and had no little influence on subsequent legislation.

MR. JUSTICE LINDLEY ON THE DUTIES OF AN AUDITOR, 1895

The most important case was that of *The London & General Bank, Ltd.** in the Court of Appeal in 1895. In a memorable judgment, quoted ever since, Mr. Justice Lindley laid down the principles which should govern an auditor in the discharge of his duties and it

* *In re London & General Bank* (No 2) (1895, 2 Ch. 673).

is generally agreed that these principles hold good at the present time. It was held that an auditor is guilty of misfeasance who, when dissatisfied with the accounts of a company, does not plainly draw attention in his report to the grounds for his dissatisfaction. From the judgment, which was a long one, I have extracted the following parts dealing generally with the duties, obligations and responsibility of the auditor :—

“ It is no part of an auditor's duty to give advice, either to directors or shareholders, as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably ; it is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that. But then comes the question : How is he to ascertain that position ? The answer is : By examining the books of the company. But he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books of the company themselves show the company's true position. He must take reasonable care to ascertain that they do. Unless he does this, his duty will be worse than an idle farce. Assuming the books to be so kept as to show the true position of a company, the auditor has to frame a balance sheet showing that position according to the books, and to certify that the balance sheet presented is correct in that sense. But his first duty is to examine the books, not merely for the purpose of ascertaining what they do show, but also for the purpose of satisfying himself that they show the true financial position of the company. This is quite in accordance with the decision of J. Stirling in *The Leeds Estate Co. v. Shephard*, in 36 Chancery Division, page 802. An auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. He is not an insurer ; he does not guarantee that the books do correctly show the true position of the company's affairs ; he does not even guarantee that his balance sheet is accurate according to the books of the company. If he did he would be responsible for error on his part, even if he were himself deceived without any want of reasonable care on his

part—say, by the fraudulent concealment of a book from him. His obligation is not so onerous as this.

“ Such I take to be the duty of the auditor ; he must be honest—that is, he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true. .

“ What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion, very little inquiry will be reasonably sufficient ; and in practice I believe business men select a few cases haphazard, see that they are right, and assume that others like them are correct also. Where suspicion is aroused more care is obviously necessary, but still an auditor is not bound to exercise more than reasonable care and skill even in a case of suspicion ; and he is perfectly justified in acting on the opinion of an expert where special knowledge is required.

.....

“ The balance sheet and certificate of February 1892 (that is, for the year 1891) was accompanied by a report to the directors of the bank. Taking the balance sheet, the certificate and report together, Mr. Theobald stated to the directors the true financial position of the bank, and if this report had been laid before the shareholders, Mr. Theobald would have completely discharged his duty to them. Unfortunately, however, this report was not laid before the shareholders, and it becomes necessary to consider the legal consequences to Mr. Theobald of this circumstance.

“ A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them or some of them, to ask for more. Information and means of information are by no means equivalent terms. Still, there may be circumstances under which information given in the shape of a printed document circulated amongst a large body of shareholders would, by its consequent publicity, be very injurious to their interests, and in such a case I am not prepared to say that an auditor would fail to discharge his duty if, instead of publishing his report in such a way as to ensure publicity, he made a confidential report to the shareholders, and invited their attention to it, and told them where they could see it. The auditor is to make a report to the shareholders, but the mode of doing so, and the form of the report, are not prescribed. If, therefore, Mr. Theobald had laid

before the shareholders the balance sheet and profit and loss account, accompanied by a certificate in the form in which he first prepared it, he would perhaps have done enough, under the peculiar circumstances of the case. I feel, however, the great danger of acting on such a principle, and in order not to be misunderstood, I will add that an auditor who gives shareholders means of information instead of information in respect of a company's financial position does so at his peril, and runs the very serious risk of being held, judicially, to have failed to discharge his duty . . . But, as already stated, the duty of an auditor is to convey information, not to arouse inquiry, and, although an auditor might infer from an unusual statement that something was seriously wrong, it by no means follows that ordinary people would have their suspicions aroused by a similar statement, if, as in this case, its language expresses no more than any ordinary person would infer without it."

COMPANIES ACT, 1900 : APPOINTMENT OF AN AUDITOR OBLIGATORY ;
HIS CERTIFICATE, REPORT AND DUTIES

The Companies Act of 1900 effected important alterations in company law. For the first time it was made obligatory for every company to appoint an auditor. Section 23 of the Act relating to the auditor's duties read as follows :—

" Every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, and shall be entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of the duties of the auditors, and the auditors shall sign a certificate at the foot of the balance sheet stating whether or not all their requirements as auditors have been complied with, and shall make a report to the shareholders on the accounts examined by them, and on every balance sheet laid before the company in general meeting during their tenure of office, and in every such report shall state whether, in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as shown by the books of the company ; and such report shall be read before the company in general meeting."*

* This wording follows almost exactly that of Section 7, Clause 6, of the Companies Act of 1879 relating to Banking Companies only, and applied in the case of *In re London & General Bank* (No. 2), referred to above.

Prior to 1900, auditors' certificates had almost invariably become stereotyped in form and restricted to the balance sheet. The Act of 1900 provided for a certificate and a report. The report had to deal, in the first place, with the accounts examined by the auditor and had to be read before the company in general meeting. There was much controversy as to the exact meaning of Section 23 and contemporary accountancy publications show that there existed considerable confusion and uncertainty as to the procedure necessary to comply with it. In December 1900, *The Accountant* published a series of articles upon "The Duties of Auditors under the Companies Act, 1900," from which I give two interesting extracts :—

"If an absolutely unqualified certificate is really all that an auditor has to report to the shareholders, then it is obvious that he will have nothing to add to the certificate as to the accuracy of the balance sheet, which the Act requires him to affix to the foot thereof, and no harm can possibly be done by omitting to give one. At the same time, now that the Legislature expressly requires that a report shall be addressed to the shareholders, considerable responsibility will necessarily rest with the auditor who omits to make such a report, especially if there is anything like a conflict of opinion as to whether or not anything ought to have been brought before the shareholders beyond the mere fact that the accounts, as rendered, are correct. For our own part, we think it will not be necessary for an auditor to recount to the shareholders the various steps leading to his certification of the accounts. But if any outstanding points still remain in which there is a bona fide difference of opinion between the directors and the auditor, these will naturally very properly form the subject of a report to the shareholders. . . . Attention may also be profitably directed to the point raised by Mr. D. F. Basden, F.C.A., in his letter appearing in our last issue—namely, that the report mentioned in Section 23 is to cover not merely the Balance Sheet laid before the Company in General Meeting, but also whatever accounts have been examined by the Auditors,

"This presumably would include not merely the trading and profit and loss accounts (one or both of which might be appended to the published accounts) but also the actual accounts, or books of account of the company."

COUNSEL'S OPINION ON THE AUDIT PROVISIONS OF THE COMPANIES
ACT, 1900

The Council of the Institute of Chartered Accountants in England and Wales subsequently took the joint opinion of four eminent Counsel. Paragraphs (5), (6) and (7) of that opinion read as follows :—

“(5) In our opinion the certificate and report referred to in Section 23 must be separate and separately signed, even though both be placed on the balance sheet. There would, however, be no objection, if it be desired, to connect the certificate with the report by inserting in the certificate a reference to the ‘subjoined’ or ‘accompanying’ report; and, as an alternative, where thought expedient, the certificate might set out the report verbatim, thus: I certify, &c., and I report to the shareholders that, &c. Signed A.B. If, however, this course be adopted, it will, in our opinion, still be necessary that the auditor should make and sign the report separately, and send it in to the directors to be placed before the shareholders.”

“(6) As regards the form of certificate, it may run thus :

“ Auditor’s Certificate ”

“In accordance with the provisions of the Companies Act, 1900, I certify that all my requirements as auditor have been complied with.”

“And the report might run thus :—

“To the shareholders of the.....Company,
Limited.

“ Auditor’s Report ”

“I have audited the above balance sheet (or the company’s balance sheet dated the.....day of.....) and in my opinion such balance sheet is properly drawn up so as to exhibit a true and correct view of the state of the company’s affairs, as shown by the books of the company.”

“(7) Section 23 of the Act of 1900 requires the auditor to report whether the balance sheet is properly drawn up, so as to exhibit a true and correct view of the state of the company’s affairs as shown by the books of the company. In our opinion these words, ‘as shown by the books of the company,’ do not limit the auditor’s duties to a comparison of the figures. No doubt he has to examine the books; but, as Lord Justice Lindley said, *In re The London and General Bank*

(1895, 2 Ch. 683): 'He does not discharge his duty by doing this without inquiry, and without taking any trouble to see that the books themselves show the company's true position. He must take reasonable care to ascertain that they do so'."

Although the Act of 1900 so clearly stated that the auditors "*shall make a report to the shareholders on the accounts examined by them*," it is significant that there is no reference whatsoever in the opinion to this very definite obligation. The opinion was accepted by the accountancy profession, however, as removing any doubts as to the proper interpretation of Section 23 and it settled the duties of auditors under the 1900 Act, for auditors did not in practice make any reference in their reports to the profit and loss account or to any "accounts examined by them" other than the balance sheet.

MR. JUSTICE BUCKLEY ON THE AUDITOR'S REPORT, 1906

In *Newton v. Birmingham Small Arms Co.** in 1906 the Court granted an injunction restraining the defendant company from acting upon a special resolution which gave the directors power to set aside out of profits a sum or sums as an internal reserve fund, without disclosing to the shareholders the creation, existence or application of such fund or the investments representing it. In the course of his judgment, Mr. Justice Buckley said:—

"The concluding sentence of Section 23 requires that the auditor shall state whether the balance sheet exhibits a true and correct view of the state of the company's affairs as shown by the books. Sir Robert Finlay argued that these words are satisfied if the auditors report that the balance sheet does not exhibit a true view and that the statute does not, in these words, say that they shall report what is the true view. This is logically true as regards the language, but, in my judgment, the statute is saved from the reproach of having achieved no more than this impotent result by words earlier in that section, which provide that the auditors are to report to the shareholders on the accounts. A report upon the accounts involves a report of the result of the accounts, and this necessarily involves, as matter of substance if not of form, the statement of a balance sheet or the equivalent of a balance sheet. There are, I agree, in the Act of

* *Newton v. Birmingham Small Arms Co.* (1906, 2 Ch. 378).

1900 no affirmative words to the effect of what I am about to state, but I think the language of the Act is sufficient to show that by implication it requires that there shall be annually an audit of accounts resulting in a balance sheet, to the accuracy of which the auditors shall speak. The special resolutions in the present case provide that the balance sheet shall not disclose the internal reserve fund. It must therefore omit on the assets side of the balance sheet the assets which make up the amount standing to the credit of that fund and the contra item—namely, the credit balance of the fund—on the liability side. The result will be to show the financial position of the company to be not as good as in fact it is. If the balance sheet be so worded as to show there is an undisclosed asset, whose existence makes the financial position better than shown, such a balance sheet will not, in my judgment, be necessarily inconsistent with the Act of Parliament. Assets are often, by reason of prudence, estimated and stated to be estimated, at less than their probably real value. The purpose of the balance sheet is primarily to show that the financial position of the company is at least as good as there stated, not to show that it is not or may not be better.”

This judgment is of importance because it has often been quoted as giving judicial authority to the proposition that a balance sheet can properly be certified as true and correct, although it shows the position in a company as being not as good as it is in fact.

COMPANIES ACT, 1907 : DUTIES OF THE AUDITOR

In 1907 another Companies Act was passed. The duty of the auditor is contained in Section 19 (2), viz. :—

“ The auditors shall make a report to the shareholders on the accounts examined by them, and on every balance sheet laid before the company in general meeting during their tenure of office, and the report shall state—

“ (a) Whether or not they have obtained all the information and explanations they have required ; and

“ (b) Whether, in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them, and as shown by the books of the company.”

It will be observed that there is little material difference in this section from the provisions of the 1900 Act. Although it had become almost the invariable practice for auditors to restrict their report to the balance sheet, the requirement to "report to the shareholders on the accounts examined by them" is repeated.

COUNSEL'S OPINION ON THE AUDIT PROVISIONS OF THE COMPANIES ACT, 1907

Again, the Institute of Chartered Accountants took the opinion of four eminent Counsel, from which I give the following extracts :—

"(1) In our opinion the auditors' report to be made pursuant to paragraph (2) of Section 19 of the Companies Act, 1907, should, in cases where the auditors have no special comments to make, run as follows :—

" Report of the auditors to the shareholders of.
Limited.

" We have audited the balance sheet of the.
Limited, dated the.day of.and
(here identify it as : ' above set forth,' or ' within contained,'
or ' a copy of which is annexed hereto and initialled by us,' or
' a copy of which has been initialled by us ').

" We have obtained all the information and explanations we
have required.

" In our opinion such balance sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of our information and the explanations given us and as shown by the books of the company."

"(8) As to the general duties of the auditors, under Section 19 of the Act of 1907, we consider that they should perform these duties with due regard to the provisions of the company's articles of association in so far as those articles are consistent with the Acts, and that they should call for all such information and explanations as they consider requisite to enable them to make the report to the shareholders contemplated by the section. They should not have the least hesitation in reporting fully as to any unsatisfactory features in the position. . . . "

This opinion conformed to the general practice which had obtained

since the 1900 Act, in regard to the form and wording of auditors' reports and has been followed by the accountancy profession to the present time.

MR. JUSTICE ROMER ON THE AUDITOR'S DUTIES IN VERIFYING
SECURITIES, 1924

From 1907 until after the Great War, there was no alteration in company law or outstanding cases in regard to accounts and audit. In 1921 the criminal trial of two of the directors and the auditor of Farrow's Bank, Ltd. aroused widespread public interest, but no issues of importance to the accountancy profession were involved.

In 1922, there occurred the failure of the City Equitable Fire Insurance Co., Ltd.* Its chief interest to the accountancy profession arose in 1924, when misfeasance proceedings were heard before Mr. Justice Romer, whose judgment was confirmed by the Court of Appeal.† The main issue was if the auditors had failed in their duty by reason of the fact that, instead of verifying securities by actual inspection, they had relied upon a certificate from the company's stockbrokers. In the course of a judgment of importance to practising accountants, Mr. Justice Romer said that it is the duty of a company's auditor in general to satisfy himself that the securities of the company in fact exist and are in safe custody, and he reviewed the circumstances in which an auditor might or might not be justified in accepting the certificates of banks or persons in whose possession such securities may have been placed. This view implies a responsibility which goes beyond the mere certification of the balance sheet.

INDEMNITY CLAUSES IN ARTICLES OF ASSOCIATION

Mr. Justice Romer expressed the view that the auditors had committed a breach of duty, but gave judgment in their favour on the ground that they were entitled to the benefit of an indemnity clause in the articles of association. Such a clause was not uncommon in companies' articles and provided that the directors, auditors and other officers of the company should be indemnified against any

* *In re City Equitable Fire Insurance Co., Ltd.* (1925, Ch. 407).

† The case of the *London & General Bank*, nearly 30 years earlier, was relied on as defining the duties and responsibilities of auditors.

loss or liability they may incur in connection with the carrying out of their duties, provided such loss or liability did not happen through their own wilful neglect or default.

COMPANIES ACT, 1929: IMPORTANT CHANGES IN, AND CONSOLIDATION OF, COMPANY LAW; EXTENDED ACCOUNT AND AUDIT PROVISIONS; OBLIGATORY PROFIT & LOSS ACCOUNT

The Company Law Amendment Committee appointed in 1925 expressed the view that the protection which an indemnity clause gave to auditors was unwarranted and should be forbidden. This was given effect to in the Companies Act of 1928, which made important changes in the law as to accounts but did not come into force, in so far as it dealt with accounts and audit, until the Consolidating Act of 1929. For the first time, provisions were included as to the form and contents of the balance sheet, and that a profit and loss account or income and expenditure account must be submitted to shareholders. The duties of an auditor were set out in Section 134 (1), which was practically identical with Section 19 (1) of the 1907 Act previously quoted.

TRIAL OF CHAIRMAN AND AUDITOR OF ROYAL MAIL STEAM PACKET COMPANY, 1931: FORM AND CONTENTS OF PROFIT & LOSS ACCOUNT

No trial affecting the liability of an auditor has aroused such intense interest within the accountancy profession as the criminal proceedings against the chairman and auditor of the Royal Mail Steam Packet Company.* in 1931. The company, which was one of the largest and most important in this country, had been constituted under a series of Royal Charters, the first of which was granted in 1839, and the auditor charged was a partner in one of the largest firms of accountants in the world. The Royal Mail Steam Packet Company was the head of the leading group of shipping companies in the Kingdom. The group consisted of some 35 companies, in six of which, frequently referred to during the trial, the Royal Mail Company owned the whole of the share capital. The accounts were extremely intricate and required close

* *R. v. Kylsant and Morland*. Reported in *The Accountant, Incorporated Accountants' Journal* and in "*The Royal Mail Case*" (Notable British Trials).

investigation to arrive at a clear comprehension of the matters involved.

(a) EVIDENCE AT THE TRIAL

The case of the Crown was that in the year 1923 there existed very substantial reserves undisclosed to the shareholders, resulting from the liability of the company to excess profits duty being settled, chiefly by reason of allowances for obsolescence and deferred repairs, at considerably less than the previously estimated amount as provided for in the accounts ; that these " old " reserves were utilised in subsequent years to build up substantial profits, which were shown in the profit and loss accounts without clear information as to their abnormal nature ; and that the profit and loss accounts consequently conveyed the impression that the company was prosperous, when in fact actual losses on trading were being experienced. It appeared from the evidence, however, that the liability to excess profits duty was not finally settled until 1927, and nearly all of the accountant witnesses, some of them called by the prosecution, expressed the opinion that it would not have been sound and proper to have taken these credits in respect of excess profits duty to profit and loss account and so have treated them as available for dividend in any years earlier than those in which they were appropriated for such purpose. Evidence was given that similar transfers to the credit of profit and loss account had been made in the case of some of the subsidiary companies, whose balance sheets had been certified by well-known accountancy firms, and whose position in regard to excess profits duty was analogous to that of the Royal Mail Company. Further than this, there was a number of accountants, some of them well known, engaged in the case on behalf of the defence, who carefully investigated the accounts and supported the view expressed by the accountant witnesses, that the excess profits duty credits had been transferred to profit and loss account in the proper years. This being so, it followed that in the balance sheets of the Royal Mail Company from 1923 to 1927, there were no undisclosed " free " reserves, although there did exist sources from which the company did eventually derive substantial benefits, which, when they

materialised by actual receipt, became profit available for dividend. Little exception was taken to the balance sheets, which were not strongly challenged even by the prosecution. In no year was the actual position less favourable than that disclosed and the balances properly available as dividend to the credit of profit and loss account were not incorrect.

(b) IMPORTANCE OF THE TRIAL TO AUDITORS

The trial really concerned the form and contents of the profit and loss account and the inclusion therein of what the prosecution contended were "old" reserves without disclosure of the fact and the amounts involved, with the result that false impressions were conveyed as to the results of the company's business. The Royal Mail Company had for years followed the practice, by no means uncommon, of giving practically no information whatsoever in the profit and loss account regarding its expenditure, or the details of its profits and revenue, but showed only the net result in one conglomerate item. At the instance of the auditor, however, there had been inserted in the profit and loss accounts for 1926 and 1927, the years in respect of which the charges were brought, the words "adjustment of taxation reserves." It may be argued that this phrase should have been a clear indication that the balances on the profit and loss account were affected by an abnormal credit and, from the very fact of the insertion of the words, that the amount involved was material. There may be differences of opinion regarding the course adopted by the auditor, but practising accountants generally had not the slightest doubt as to the baselessness of a criminal charge. The verdict of the jury, wholly in favour of the auditor, was received with satisfaction by everyone having the interests of the accountancy profession at heart, but the trial emphasised the weakness in the prevailing practice relating to the published balance sheets and accounts of public companies and caused no little uneasiness as to the extent of the responsibilities of auditors. Very considerable controversy has taken place amongst members of the accountancy profession in this and other countries, particularly as to, firstly, the propriety of undisclosed or secret reserves, and

secondly, the form and contents of the profit and loss account.

On these two subjects much has been said and written by prominent members of our profession and numerous articles have appeared in the accountancy publications and the leading daily and financial newspapers and periodicals. There has been so much divergence of opinion that I want to make it quite clear I am not attempting to define the attitude of the British accountancy profession in these matters. I am expressing my own personal opinions. Views, however, have been clarified since 1931 and there is a tendency to make the published accounts of many public companies more informative.

(c) MR. JUSTICE WRIGHT ON SECRET RESERVES

In his address to the jury in the *Royal Mail* trial, Mr. Justice Wright made the following observations on the subject of Secret Reserves :—

“ We have heard a great deal about the keeping of secret reserves, and we have heard a great deal about the commercial troubles which may flow from that practice. We have heard a great deal about what is often done in practice, and it may be reasonably and properly done, but the question may arise some day, and possibly will arise, in some appropriate proceeding, in order to find out and elucidate these very special matters. It was said by a very learned Judge on one occasion, by way of observation and not by judgment, that a company, that is to say the shareholders, could not complain if the position of the finances of the company was better than the accounts disclosed. That has been quoted from time to time as a justification for this method of keeping reserves secret. But there may be very great evils if those who have the control and management of the companies, and who control and manage companies for the benefit of the shareholders who entrust their moneys to companies, have very large portions of the company's assets left in the secret disposition of the managing authority. It may work very well in many cases ; no doubt it does. It is a practice which is being followed, no doubt, by many concerns of the highest standing. On the other hand, it may be the subject of almost intolerable abuse. Such a system may be used to cover up negligences, irregularities, and almost breaches of faith. It is said to be a matter of domestic concern between the

company and the shareholders, but if shareholders do not know and cannot know what the position is, how can they form any view about it at all ? ”

AUDITOR'S DUTY IN RELATION TO SECRET RESERVES

In November, 1931, when I was President of the Society of Incorporated Accountants and Auditors, I spoke upon the question of Secret Reserves, and said, *inter alia* :—

“ It should be borne in mind that a secret reserve can arise only through an under-statement of profit and in no other way, and it cannot be denied that balance sheets or profit and loss accounts which are affected by secret reserves are untrue to the extent of such reserves.

“ I am aware that among practising accountants there is a considerable divergence of opinion regarding the propriety of secret reserves. I have heard leading accountants express the view that provided the creation, existence or utilisation of a reserve is noted in the accounts the non-disclosure of the actual amount is justifiable but it is my personal opinion that it is not consistent with the statutory form of the auditor's certificate, which in such case I consider should be qualified by the use of words such as ‘ subject to the non-disclosure of the amount of the reserve referred to in the balance sheet or profit and loss account ’ as the case may be.”

AUDITOR'S DUTY IN RELATION TO GROUPED ITEMS IN THE PROFIT AND LOSS ACCOUNT

In December 1931, in emphasising the importance of the profit and loss account, I deprecated the practice (not infrequently followed) of “ grouping in one item, profit on trading, income from investments and properties, royalties and revenue and profits from every source, even though of an abnormal or temporary character,” and concluded by suggesting that “ the auditor's responsibility for the profit and loss account should be placed beyond question and his certificate should be extended by the addition of some such phrase as ‘ the profit and loss account is a true and correct statement showing the profit earned (or loss incurred) during the period covered by that account ’ .”

COUNSEL'S OPINION ON RESERVES, 1931

In December 1931, the Institute of Chartered Accountants issued to its members the opinion of Mr. Wilfrid Greene, K.C. and Mr. Cecil W. Turner on the question as to whether that body could properly and usefully issue any form of general pronouncement for the guidance of their members on the questions and matters discussed in the recent trial arising out of the affairs of the Royal Mail Steam Packet Company. The opinion was to the effect that no such pronouncement was really feasible. After giving their reasons, Counsel referred to what are often termed "secret" or "undisclosed" or "inner" reserves in the following terms :—

"When these expressions are examined, it becomes apparent that they are not expressions which have a clear and well defined meaning, and that they, or one or more of them, may be applied to a number of different types of reserve. Probably even experienced accountants would not all agree as to their exact scope and meaning. It follows, therefore, that a general proposition which might be applicable to one type of 'secret' reserve might not be equally applicable to another, or that a given proposition might be applicable to a flagrant or extreme case, though not to one where no 'misleading' was involved."

PROPRIETY AND UTILISATION OF SECRET RESERVES

Much more helpful to members of the accountancy profession were the views expressed by Lord Plender in a paper read by him in February 1932, when he said :—

"Inner or secret reserves and their propriety—if not legality—have recently been the subject of judicial comment. Such reserves may exist, for example, in the excessive writing down of the book values of assets, of under-valuation of investments, or in provisions for contingencies the amount of which is not specifically set out on the balance sheet. In my opinion directors should be entitled, in the interests of a company and its shareholders, to make reasonable provisions for contingencies and should be allowed discretion in so doing without necessarily being required to disclose the amount of the provisions in the balance sheet. . . . The reserve for contingencies is generally included in an omnibus item on the liabilities side of the balance sheet (such as 'creditors including provision for

contingencies') and in my view it is necessary that its existence should be indicated by suitable wording. The use of such reserves in relief of losses or by way of supplement to profits should, I think, be indicated to the shareholders, and except in comparatively rare cases the amount so used should be stated. The origin and utilisation of undisclosed reserves covers such a wide field of circumstances that it is not possible to dogmatise on the question, and a decision as to the right course to pursue can only be arrived at after a full consideration of the facts in each individual case."

This statement, which had been preceded by considerable discussion in the Press as to the utilisation of undisclosed reserves in relation to the profit and loss account, certainly had some influence on practice, for certain well-known companies disclosed in their profit and loss accounts the inclusion of reserves or provisions no longer required from previous years. Amongst accountants there must be agreement that the use of undisclosed reserves should be indicated and that the amounts should generally be stated if the profit and loss account is to show the profit-earning capacity of a company. If, however, it is accepted that the *utilisation* of reserves and of surplus provisions made in an earlier year must be disclosed, then there can be little advantage in *creating* reserves without disclosure, and whatever argument may be advanced in favour of non-disclosure on the ground of expediency, it cannot be contended that it is strictly in accord with sound accountancy principles.

NECESSITY TO DISCLOSE CERTAIN RESERVES IN ACCOUNTS

Although circumstances might arise that would justify or necessitate a provision for "contingencies," the non-disclosure in a balance sheet of a "free" reserve, in its true sense, can be made only with the object of creating in the minds of shareholders or the public the impression that the company's affairs are in a position which is not in accordance with the facts. There may be no wrong intention on the part of the directors, who may think they are acting in the best interests of the company, but such a balance sheet should not, in my opinion, bear an auditor's unqualified report as to its truth and correctness. If the actual amount of a secret reserve is

immaterial, there cannot be any real object in creating it ; if it is material, I fail to see how its non-disclosure can be defended.

DIFFERENT KINDS OF RESERVES

No little confusion has been caused by the loose and indiscriminate way in which the word " reserve " has been used in connection with accounts. It is most frequently accompanied by a qualifying word or expression, as in " reserve for accrued liabilities," " reserve for bad debts," " stock reserve," " reserve for loss on exchange," " reserve for depreciation," " leasehold depreciation reserve " or " reserve for income-tax." Ordinarily the character of these items is such that they have to be taken into account in arriving at the profit or loss and no objection could reasonably be taken to their non-disclosure. If accountants would adopt the practice of calling them " provisions "—which, in fact, they are—much misunderstanding would be avoided. In addition, we may have a " general reserve," " capital reserve," " reserve for equalisation of dividends," or " debenture redemption reserve." These are reserves in the true sense of the term ; they originate most frequently from an appropriation of profit and are almost invariably set out clearly in balance sheets. Further, we may have an " internal reserve " or a " reserve for contingencies." In many cases such reserves if undisclosed would be synonymous with the term " secret reserve."

I want to make it clear that in the term " secret reserve " I do not include the making of proper provisions for estimated losses or expenses not definitely ascertainable at the date of making up the accounts. I mean undisclosed reserves which arise from an understatement of profit. " Secret reserves " as long as they exist, affect the balance sheet, in which they may be reflected by over-stating liabilities or by under-valuing assets, but they do not affect the profit and loss account except in the periods when they originate or when they are utilised to increase the profit or reduce the loss.

CONTENTS OF BALANCE SHEETS UNDER COMPANIES ACT, 1929

The Companies Act of 1929 strengthened the position of the auditor in relation to the balance sheet by including provisions as to its contents. Sections 124 and 125 read as follows :—

“ 124. (1) Every balance sheet of a company shall contain a summary of the authorised share capital and of the issued share capital of the company, its liabilities and its assets, together with such particulars as are necessary to disclose the general nature of the liabilities and the assets of the company and to distinguish between the amounts respectively of the fixed assets and of the floating assets, and shall state how the values of the fixed assets have been arrived at.

“ (2) There shall be stated under separate headings in the balance sheet so far as they are not written off :—

“ (a) The preliminary expenses of the company ; and

“ (b) Any expenses incurred in connection with any issue of share capital or debentures ; and

“ (c) If it is shown as a separate item in or is otherwise ascertainable from the books of the company, or from any contract for the sale or purchase of any property to be acquired by the company, or from any documents in the possession of the company relating to the stamp duty payable in respect of any such contract or the conveyance of any such property, the amount of the goodwill and of any patents and trademarks as so shown or ascertained.

“ (3) Where any liability of the company is secured otherwise than by operation of law on any assets of the company, the balance sheet shall include a statement that that liability is so secured, but it shall not be necessary to specify in the balance sheet the assets on which the liability is secured.

“ (4) The provisions of this section are in addition to other provisions of this Act requiring other matters to be stated in balance sheets.”

“ 125. Where any of the assets of a company consist of shares in, or amounts owing (whether on account of a loan or otherwise) from a subsidiary company or subsidiary companies, the aggregate amount of those assets, distinguishing shares and indebtedness, shall be set out in the balance sheet of the first-mentioned company separately from all its other assets, and where a company is indebted, whether on account of a loan or otherwise, to a subsidiary company or subsidiary companies, the aggregate amount of that indebtedness shall be set out in the balance sheet of that company separately from all its other liabilities.”

DISCLOSURE OF LOANS TO DIRECTORS AND OFFICERS AND
REMUNERATION OF DIRECTORS

The 1929 Act provides that the accounts to be laid before every company in general meeting shall contain certain particulars relating to loans to any director or officer of the company, and remuneration paid to directors. The obligation to furnish these particulars rests primarily upon the directors, for Section 128 (4) reads as follows :—

“ 128. (4) If in the case of any such accounts as aforesaid the requirements of this section are not complied with, it shall be the duty of the auditors of the company by whom the accounts are examined to include in their report on the balance sheet of the company, so far as they are reasonably able to do so, a statement giving the required particulars.”

CONDITIONS TO BE SATISFIED BY THE BALANCE SHEET

Strictly speaking, the settlement of the form and contents of the balance sheet is the responsibility of the directors and the auditor's function is restricted to reporting upon it. In practice, however, the balance sheet is almost invariably submitted to the auditor for his approval before it is finally settled in order to avoid qualifications in his report.

I suggest that before an auditor would be justified in making an unqualified report in accordance with the wording of the Companies Act 1929, the balance sheet should satisfy the following conditions :

- (1) It should be properly drawn up.
- (2) It should be true.
- (3) It should be correctly stated.
- (4) It should be in accordance with the books.
- (5) It must not convey a misleading impression as to the state of affairs of the company.

The first, second and fourth of these conditions should not present any special difficulties, and if the first four are complied with, the last would almost certainly be fulfilled.

Before the Companies Act of 1929, it might have been largely a matter of opinion if a balance sheet was “ properly drawn up,” but as Sections 124 and 125 of that Act specify the form and contents of the balance sheet, a balance sheet would generally be regarded as

“properly drawn up” if the requirements of these sections are complied with. If what is stated in a balance sheet is true and if a balance sheet is in accordance with the books, are generally questions of fact and capable of verification, but the difficulty arises when the auditor has to decide if the various items are *correctly stated*, since this is frequently a matter of opinion. Before a balance sheet can be regarded as correctly stated, it must conform to sound accountancy principles. What is true is not necessarily correctly stated : for instance, it may be true to state that stock is taken at cost, but it would not usually be correct to state it so, if at the date of the balance sheet there had been a fall in market value. Again, if shares in a subsidiary company were shown “at cost,” it would be true, but if a part of the capital of such subsidiary company had been lost, judged by sound commercial and accountancy principles, the item would not be correctly stated. It is my view that, if the losses of a subsidiary are not dealt with by reducing the amount at which the investment appears or by making proper provision on the liabilities side of the balance sheet, the auditor should call attention thereto in his report.

If a balance sheet does not comply with the five conditions which I have enumerated, it becomes the duty of the auditor to call attention in his report to the shareholders to any omission and to any and every item to which he takes exception. The wording employed should be sufficiently clear and definite to avoid misunderstanding, but it is not part of the auditor's duty actually to rectify any misstatement or omission in the balance sheet, or to express his opinion as to the amount that is involved thereby.

IMPORTANCE OF EARNING CAPACITY IN PROFIT AND LOSS ACCOUNTS

I have mentioned it was not until the Companies Act of 1929 that there were any provisions requiring that a profit and loss account should be submitted to shareholders. I cannot trace that the expression “profit and loss account” appeared in any of the Companies Acts prior to 1928. Further, in reports of the leading cases regarding the duties of auditors practically no references to the profit and loss account appear and the judgments have dealt with

the auditor's obligations in relation to the balance sheet. An outstanding feature of the *Royal Mail* trial was that it was the first case of importance in the English Civil or Criminal Courts in which the auditor's responsibility for the profit and loss account had been raised. This is surprising in view of the increasing attention which has been directed to earning capacity, upon which share values are largely based. The importance of earning capacity in relation to capital asset values was clearly expressed by Lord Plender in the paper to which I have referred and from which I again quote :—

“ As regards the profit and loss account, it may be found that in a number of instances the information given in this account, however abbreviated in form, is of as much value to the shareholder in affording a guide to the company's position and progress as the information in the balance sheet, however much greater in volume the latter information may be. After all, the value of the assets of a business, considered as a whole, really depends on what they are capable of earning in the form of annual profits ; and consequently the figure of net profit which should be shown in a profit and loss account, when considered in conjunction with similar figures relating to previous financial years, may give the shareholder a fairly true indication of the real value of the enterprise which the company owns. I am, of course, speaking in very general terms.”

Lord Plender very truly added that “ Whatever the book value of fixed assets may be, their real value lies—with certain exceptions—in their earning capacity.” It is, therefore, not too much to say that a balance sheet which includes fixed assets such as factories, plant and machinery, may be of little, if any, value as exhibiting a true and correctly stated view of the company's affairs, unless it is accompanied by a true and correct statement of profit-earning capacity. In the case of many companies, their solvency must be dependent on their continuing capacity to earn profits.

If further proof were required of the importance of the profit and loss account, one need only examine the publications which review the reports and accounts of public companies. The particulars which are invariably set out relate not only to the balance sheet but to the profit or loss for the year and the appropriation of the profit. A governing factor in estimating the value of a company's shares is the

earning capacity in relation to the capital and, therefore, the profit and loss account is a very important account to the shareholder.

AUDITOR'S OBLIGATION TO REPORT ON PROFIT AND LOSS ACCOUNTS
UNDER THE COMPANIES ACT, 1929

In considering the auditor's responsibility in relation to the balance sheet we are greatly assisted, firstly, by the provisions of the Companies Acts, in which the auditor's responsibility and duties are laid down ; secondly, by numerous judgments in cases decided in the Courts, some of which I have already referred to ; and, thirdly, by practice, which to a large extent may be regarded as well established. In the case of the profit and loss account, however, no such extensive assistance is available. The Companies Act of 1929, in first referring to the profit and loss account, gave no indication as to its form and contents or the function it is intended to serve. I have mentioned that until the *Royal Mail* trial, there do not appear ever to have been any proceedings in the Civil or Criminal Courts as to the responsibility of an auditor in relation to the profit and loss account and I have not observed in the published reports of the auditors of public companies that exception has been taken, or even reference made, to the form and contents of the profit and loss account or the result which it shows. In practically every case which I have examined, any qualification in the auditors' report has had reference to the balance sheet.

The opinion of Counsel to which I have referred, arising from the *Royal Mail* case, concluded with the following reference to the profit and loss account :

“ We have been asked whether the duties and responsibilities of an auditor extend to the profit and loss account, though it is not specifically reported upon to the members of a company. In our opinion having regard to the fact that the balance sheet contains as one of its items the balance brought in from the profit and loss account, they cannot dissociate themselves from all responsibility for the correctness of that account and there may be cases in which it would be incumbent upon them to draw the attention of the shareholders to any feature of that account which in their view involved anything of any improper or misleading character.”

I agree with the conclusions of Counsel as to the obligations of an auditor in relation to the profit and loss account, but I consider such obligation to be directly imposed by the Act and not arising, as they indicate, by implication. The 1929 Act provides for the submission to shareholders of a profit and loss account, and surely an auditor should examine with the greatest care an account which the law requires to be placed before the owners of the company. The first duty of the auditor is to "make a report to the shareholders on the accounts examined by him," and it is difficult, therefore, to see how it could logically be contended that the Companies Act does not impose upon the auditor a definite obligation to report on the profit and loss account and most certainly so if in any respect it is untrue, incorrectly stated or misleading.

However, whether the auditor's responsibility for the profit and loss account is definitely imposed by the Companies Act or whether it arises by implication owing to the inclusion of the balance of the profit and loss account in the balance sheet, the responsibility certainly exists.

NATURE OF THE PROFIT AND LOSS ACCOUNT

The term "profit and loss account" in the system of double-entry bookkeeping is the title of one of the nominal accounts in the books of all companies trading for profit. It is made up of debit and credit balances transferred from other nominal accounts and the resulting balance represents the profit or loss for the period. This, of course, is elementary and is well understood by accountants, bookkeepers and business men. The profit and loss account being part of the bookkeeping system, and not, like the balance sheet, a summarised statement of all the balances in the books after they have been closed, one might have expected that the Act would have referred to *the* profit and loss account or to a statement or summary of *the* profit and loss account. The Act refers, however, to *a* profit and loss account and from this it is to be inferred that considerable latitude is given as to what information and particulars in the profit and loss account, as it appears in the books, should be included in the profit and loss account required by the Act. In practice the profit and loss account issued to shareholders bears little resemblance

to the account in the books, for almost invariably there are omitted all particulars of the trading and practically all items of expenditure.

FUNCTION OF THE PROFIT AND LOSS ACCOUNT

The function of a profit and loss account is to show the profit earned or loss suffered by a company during the period which such account is expressed to cover. This is undoubtedly its function in the view of shareholders, but the law requires the balance shown to the credit of the profit and loss account to be the amount properly available for distribution as dividend, and we know that such balance may differ greatly from the actual trading results for the period.

FORM AND CONTENTS OF THE PROFIT AND LOSS ACCOUNT

If it were intended by the Act that the profit and loss account need do no more than disclose the balance available for dividend, it would be of little value to shareholders, for such information could usually be ascertained from the profit and loss item in the balance sheet. The varieties of businesses carried on by companies are so numerous and complex that anything in the nature of uniformity in form and contents in the account is obviously impossible, whilst directors, for reasons quite proper and understandable, are usually opposed to unnecessary disclosure of detailed information regarding the businesses of the companies which they administer. It is generally agreed that the *extent* of the information to be disclosed must largely remain a matter as between directors and shareholders and that an obligation to include particulars of an internal nature would in many cases operate greatly to the detriment of the interests of shareholders. If, however, the profit and loss account is to be of value to shareholders and the risk of their being misled is to be avoided, certain general principles must be observed. Surely there should be little difficulty and not much difference of opinion amongst accountants, in deciding what those general principles should be.

RECOMMENDATIONS OF THE SOCIETY OF INCORPORATED ACCOUNTANTS AND AUDITORS REGARDING THE PROFIT AND LOSS ACCOUNT

The only pronouncement by any professional body regarding the profit and loss account was made in April 1932 by the Society of

Incorporated Accountants and Auditors. In November 1931, the Council of the Society appointed a committee to consider and report whether in their opinion any amendment of the law was deemed necessary and/or what, if any, alterations of a voluntary character may be considered desirable in the compilation of company accounts or their certification by professional auditors. That committee reported in favour of amending legislation and indicated what alterations should be made. The profit and loss account was dealt with in the first two paragraphs of Clause 5 of the report, which read as follows :

- “ (a) That the profit and loss account should show the true balance of profit or loss for the period covered by such account.
- “ (b) That in the profit and loss account any debits or credits which are abnormal in character or extraneous in their nature to the ordinary transactions of the company, together with any reserves from a previous period no longer required, should be stated separately.”

In the first paragraph there is the enunciation of a principle with which few, if any, members of the accountancy profession will disagree ; in the second, there are set out certain matters which should be stated in the profit and loss account to ensure adherence to the principle of paragraph one. I ought to add, however, that some directors and others responsible for the management of public companies, would assert that compulsion to adhere to this principle in all circumstances would not be in the best interests of shareholders. One aspect of this particular problem is referred to in paragraph 6 of the report, which recognised certain difficulties in giving effect to the recommendations of the committee in the case of banking and similar institutions, such as discount houses and the like. The committee felt, however, “ that the paramount consideration is the maintenance of public confidence in the administration of industrial, commercial and financial undertakings.”

In the profit and loss account the directors' remuneration required by law to be disclosed is usually stated as a separate item. In my opinion, it is desirable that the profit and loss account should also

include, as separate items on the debit side, interest on loans or loan capital and income-tax—both of which are somewhat in the nature of appropriations of profit—and, on the credit side, income from property or assets not used in connection with the carrying on of the company's business, such as outside investments.

It is the usual practice to aggregate the profits of, or the income from, subsidiary companies with the results of the holding company's business, and this practice is sound and proper since subsidiary companies are most frequently branches or departments of the holding company. Profits of subsidiaries are generally capable of regulation at the instance of the holding company, according to the basis of inter-company transactions, and no useful purpose would be served by showing the profits or dividends of subsidiaries as separate items.

CONDITIONS TO BE SATISFIED BY THE PROFIT AND LOSS ACCOUNT

I maintain that we should apply to the profit and loss account a standard no lower than that of the balance sheet. The profit and loss account would then have to satisfy the following conditions :—

- (1) It should be true.
- (2) It should be correctly stated.
- (3) It must not convey a misleading impression as to the results of the company's business.

In the *Royal Mail* case the impressions conveyed by the profit and loss account constituted the foundation for criminal charges, and that such charges could have been brought at all establishes conclusively that the responsibility of the auditor in relation to that account is a very real and serious one. The law regarding the duties and powers of an auditor is of little value, however, whilst Counsel's opinion arising from the *Royal Mail* case has disturbed and perplexed many members of the accountancy profession.

I think that most accountants to-day would agree that if *any* feature of the profit and loss account involved *anything* of an improper or misleading character, it would be the auditor's duty to draw attention to it in his report. What we should regard as being improper or misleading, however, presents a problem of no little

difficulty, having regard to current law and practice, especially in regard to holding and subsidiary companies. There is no doubt that the great majority of shareholders regard the balance shown by the profit and loss account as representing the actual result for the period covered by the account, and it follows that, unless it is clearly shown in what respects and to what extent the balance shown differs from the actual earnings, the profit and loss account is apt to be misleading to the majority of shareholders.

AUDITOR'S RESPONSIBILITY FOR THE SOUND AND PROPER TREATMENT OF THE RESULTS OF SUBSIDIARY COMPANIES IN THE ACCOUNTS OF THE HOLDING COMPANY

Unless the results of subsidiary companies are soundly and properly dealt with in the accounts of the holding company, such accounts may convey entirely wrong impressions.

If the profit and loss account of a holding company does not reflect the correct result of the business as a whole, I am of opinion it is the duty of the auditor to draw the attention of shareholders thereto in his report.

The provisions of the 1929 Act, however, as to the inclusion of the results of subsidiary companies in the accounts of the holding company, have been generally criticised and, from the accountancy standpoint, are unsatisfactory. Section 126 provides for disclosure as to how the profits and losses of subsidiary companies have been dealt with in, or for the purposes of, the accounts of the holding company and there is a proviso that it shall not be necessary to specify the actual amount of profits or losses of any subsidiary companies which have been dealt with in any particular manner. It should be noted that the section recognises the dependence of the results of a holding company's business upon the profits or losses of its subsidiaries.

The statement as to how the profits and losses of subsidiary companies have been dealt with has to be signed by the directors. Can it be said, therefore, that the auditor can "dissociate himself from all responsibility" in relation to the account upon which such statement is based? The unsound treatment of the results of subsidiaries in

the accounts of a holding company may cause the profit and loss account to give a misleading impression as to the actual results of the holding company's business. A person with an expert knowledge of accounts would infer from the kind of directors' statement which is so frequently appended to accounts to comply with Section 126, that the profit and loss account of the holding company cannot be relied on as indicating the earning capacity for the period covered by the account. But such inference would not necessarily be drawn by the "ordinary" shareholder, who would conclude that the balance of profit and loss account if described therein as "net profit" and referred to as such by the directors in their report, actually represented the profit earned during the year.

Surely it is not contended, because Section 126 requires disclosure as to *how* the profits or losses of subsidiaries have been dealt with, that there is no obligation to see that they have been dealt with on sound and proper lines for the purposes of the accounts of the holding company. Consider the case of a holding company whose statement regarding its subsidiaries is in a form very frequently adopted, namely, "that the profits of subsidiary companies have been included in the profit and loss account to the extent of dividends declared." If it has been the practice of the subsidiary companies to declare dividends approximating to the profit earned each year—which is a sound practice—the profit and loss account of the holding company would show the correct result of the holding company and its subsidiaries as a whole. If, however, the dividends of the subsidiaries arise from profits earned in past years, which have been held up and carried forward in the accounts of the subsidiaries, then the profit and loss account of the holding company would convey a misleading impression as to the profit earned during the period covered by the account.

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT ARE COMPLEMENTARY AND THE AUDITOR'S DUTY EXTENDS TO BOTH

Some members of the accountancy profession may consider that the personal views I have expressed regarding the duties of an

auditor go beyond what can reasonably be expected in actual practice. I cannot see that there is greater responsibility in expressing an opinion as to whether the profit and loss account conveys a true and correct impression of the result of a company's business, than in expressing an opinion as to whether the balance sheet shows a true and correct view of the state of its affairs. It may be an additional, but it is not, I maintain, a *greater* responsibility and any difficulties must generally be common both to the balance sheet and the profit and loss account, because the one is the complement of the other. If the balance sheet is true and correctly stated the profit and loss account will convey a true and correct impression, provided abnormal, extraneous and non-recurrent items are separately stated and the results of subsidiary companies are properly treated.

NATURE OF AMENDING LEGISLATION REQUIRED

Accountants cannot ignore the fact that the ineffective provisions of the Companies Act regarding subsidiary companies, and the considerable extension of the group system and the subsidiary company principle, have had the effect of making the accounts of public companies far less informative and less reliable than they were 20 years ago. The remedy for this unsatisfactory state of affairs is suggested in the concluding paragraph of the report of the Society of Incorporated Accountants and Auditors, which reads :—

“ We do not consider it desirable to make any recommendations for alterations of a voluntary character in the compilation and/or certification of company accounts, since in dealing with such alterations auditors might be placed in a difficult position in regard to the law as it now stands. The only effective action must be by amending legislation.”

In my opinion, the power of the auditor should be strengthened by amending the Companies Act of 1929 in regard to :—

- (1) The profit and loss account ;
- (2) The duties of the auditor ; and
- (3) The treatment of subsidiary companies in connection with the accounts of holding companies.

I fully recognise the difficulty, the undesirability, indeed, I might say the impossibility, of laying down conditions regarding the

actual form and contents of the profit and loss account, but it is not beyond the capacity of the accountancy profession to define general principles which would minimise the risk of shareholders and the public being misled. In the profit and loss account there should not be included *without disclosure* any sums which do not relate to the trading operations for the period, either directly or through the medium of subsidiary companies.

The duties of the auditor regarding the profit and loss account should be defined as in the case of the balance sheet. Responsibility for the profit and loss account certainly exists, and to discharge it the auditor should be required to report specifically on the profit and loss account as well as on the balance sheet. The public is entitled to the valuable protection which would be afforded by enacting, in effect, that the auditor's report should relate to all accounts required to be submitted to shareholders.

There appears to be general agreement as to the unsatisfactory character of the law relating to the treatment of subsidiary companies in connection with the accounts of holding companies. In amending legislation, provisions should be made to ensure adherence to sound accountancy principles and to prevent subsidiary companies being used for the purpose of withholding information which the holding company would have to disclose.

Amendment of the Companies Act is being urged in several responsible quarters and it is certain that some material alterations will be introduced regarding accounts and audit. Although the directors of the great majority of public companies do not restrict themselves to the observance of the strict letter of the law, but present their accounts in a form to which no exception can be taken, there is still a large number of cases, principally amongst companies engaged in productive and trading businesses, where the published accounts are uninformative, frequently unreliable, and occasionally even misleading, in spite of the fact that the actual requirements of the Companies Act may have been complied with.

The accountancy profession stands high in the estimation of the public. We have been described as "the watchdogs of the shareholders" and great reliance is placed by the investing public on the

accounts which we certify. Our responsibility is great and serious and to maintain the confidence we enjoy, we must use our influence, and direct our efforts, to securing such improvement in the law and practice of accountancy as will ensure that the accounts which we audit are true and correct and are sufficiently informative to prevent misleading impressions being conveyed as to the state of affairs of a company and the result of its operations.

THE AUDITOR'S RESPONSIBILITY IN RELATION
TO BALANCE SHEETS AND PROFIT
AND LOSS ACCOUNTS
THE CONTINENTAL POINT OF VIEW

BY

DR. WILHELM VOSS

The subject which I propose to discuss has been on the agenda of every International Congress of Accountants. It continually forms the central theme of all discussions affecting our profession, particularly when we are discussing the certification of balance sheets, or secret reserves, professional practice generally or any other issue of practical importance. And there is good reason for this. In the last analysis the justification for the existence of our profession depends on the amount of responsibility which we bear for our audit work, or, in other words, the extent to which we are willing or able to bear responsibility for our work.

It need scarcely be mentioned that the "safety first" point of view cannot be the decisive factor here. We know that in our profession we have got to take responsibility, but there should be complete clearness within and without our profession on the following points :

- (1) What principles determine our responsibility.
- (2) Within the scope of these principles, what rules determine the limits of the degree of responsibility—
 - (a) that should be expected of us, and
 - (b) that we can bear in the extreme case.

I.—SOME ASPECTS OF THE PROBLEM

My task is to discuss in this paper our subject particularly from the Continental standpoint. Incidentally I would remark that I do not think that the *principles* regarding our responsibility are really different in the various countries. In my view, Professor Limperg was right when he observed in his paper read before the Amsterdam

Congress of Accountants that it is not the instructions of the client that should be decisive in measuring our responsibility but the purpose for which the audit is being carried out, and this purpose is fundamentally the same in the case of the normal audit of the annual accounts of a company in Holland, the United States, Great Britain, Germany or in any other country.

On the other hand the *rules* which within the scope of these principles define the limits of our responsibility, either extending or contracting these limits, are not identical in every country. They depend on the legal system of the particular country and on the degree of development and general standing of the profession of that country and on many other factors.

How then do matters stand in regard to the responsibility of our profession for annual accounts *on the European Continent*? The differences are actually very substantial, particularly in reference to the legal enactments. For instance, in some parts of Europe a compulsory audit of the annual accounts is not prescribed at all, in others, it is not undertaken by professional accountants: the scope of the audit is also by no means uniformly laid down in every country, in some cases we find extremely detailed regulations, in others, only generalised instructions, and again in others, special provisions regarding the responsibility of the auditor. In these circumstances I do not think it will serve any useful purpose to describe the legal or the actual position of our profession in the various Continental countries. The result would be to give a blurred picture of the whole, particularly since in almost all Continental countries the development of our profession has by no means ceased, and as there are movements on foot in nearly all countries to define afresh the standing and functions of our profession. I have therefore good reasons for limiting my subject and for dealing in a more detailed manner with the conditions in Germany. Though I deal with the matter mainly from the German standpoint I think it is fair to say that the remarks which follow are substantially equally applicable to the remaining Continental countries, as far as concerns the basic questions of professional conduct, though, of course, each country has its own system of law for dealing with these matters.

I must also limit my subject in one further direction. We are only discussing the responsibility for the normal audit of the annual accounts. I, therefore, do not discuss further matters which would be of importance in considering the preparation and audit of accounts for special purposes, e.g. for borrowing purposes or for reconstructions or for liquidations.

I wish, however, to extend the limits of my paper in one direction. I deal hereunder in some detail with the recent enactments regulating the position and responsibilities of our profession in Germany, and I also describe the probable future trend of the relative legislation in Germany. These developments have taken place since the Congress held in Amsterdam, and for that reason alone would deserve special mention by a speaker dealing with the German matters. I also give in an appendix the full text (with unimportant abridgments) of the recent amendments to the Commercial Code of Germany. These amendments not only prescribe definite and detailed rules as to the valuation of items for balance sheet purposes but also lay down the form of the balance sheet and the profit and loss account which must be adopted by all public companies (Aktiengesellschaften) in Germany for their published accounts. In most countries special classes of undertakings, e.g. railway companies, are bound to statutorily prescribed forms of accounts, and the provision of a form of accounts to be applicable to all companies or of a number of forms of accounts each applicable to one class of undertaking has often formed the subject of discussion in professional circles the whole world over. Germany has now dealt with this question by legal enactment and I am sure that the solution reached will be studied with interest.

II.—PRESENT-DAY ORGANISATION OF THE PROFESSION IN GERMANY

Under date of 19th September 1931, the Government then in power issued a decree to amend and reform certain parts of the company law. Partly as a result of this decree and partly as a result of other legislation which was carried through at the same time the status and functions of our profession have been fundamentally changed in Germany. It is too early yet to regard the reforms as finally consolidated ; we are expecting the Government to bring out

a new company law in the course of the next few months which will naturally embody the legal and economic principles which govern the political situation of Germany to-day. There is no doubt that the new company law will be based substantially on the decree of 19th September 1931, and it is quite certain that the compulsory audit of public companies (Aktiengesellschaften) will form the central theme of this law, as it formed the central theme of the decree now governing the interim period. In responsible Government circles there has been, and there still is, the conviction that an effective reform of the law and procedure respecting companies can only be attained when the individual reforms are based on the principle that companies must be subjected to an audit comprising not only a comparison of the accounts presented with the books but also a verification of the individual items by reference to the underlying evidence.

These reforms necessitated changes amounting to an entire re-organisation of our profession. For the carrying out of these audits a qualified body of auditors, i.e. men uniformly qualified as regards their personal and professional qualifications, was needed. For this purpose there was created by virtue of enactments of the Reich Government and of the Governments of the various States concerned a special profession within the group of persons who had hitherto practised in Germany as accountants or trustees of various kinds, called "Publicly Appointed Approved Auditors" (Wirtschaftsprüfer).

The remarks which now follow give, of course, only an outline of the position ; considerations of space compel me to confine myself to matters of importance only : The "approved auditor," in accordance with his official designation, "publicly appointed approved auditor," is an expert who before being admitted has taken an oath and who, as a member of a liberal profession, undertakes audits, in particular the audits compulsorily prescribed by law. He must make his profession his main activity and he is prohibited from engaging in commercial pursuits. His appointment is made by the Governments of the States, and the authority for the appointment is contained in an agreement concluded between the Reich Government and the State Governments, regulating the matter uniformly for all States.

The appointment, however, is valid for the whole of Germany.

“ Approved auditing companies ” are public limited companies (Aktiengesellschaften) and private limited companies (Gesellschaften mit beschränkter Haftung, or, for short, G.m.b.H.) and other associations of individuals, in particular partnerships, which devote themselves exclusively to the work carried out by approved auditors. A special procedure has been set up in order to ensure that the persons directing these companies shall have the capacities, personal and professional, required of individual approved auditors ; and thereupon, after being entered in a register kept by the Board for publicly appointed approved auditors, they are admitted to practice as auditors. Branch offices which are carried on as independent units may only carry out compulsory audits if the local manager or partner in question is himself an approved auditor.

The conditions of admission offer a guarantee that only persons having suitable personal and professional qualifications are selected.

The applicant must—

- (1) be of acknowledged financial probity ;
- (2) be regarded as being particularly suited to the profession by reason of his personal character ;
- (3) be at least 30 years of age ;
- (4) have had practical experience of business for at least six years, of which at least three years must have been spent in auditing ;
- (5) pass an examination dealing with all matters of practical importance to an auditor.

The primary functions of approved auditors and auditing companies are :—

- (1) The compulsory audit of public companies.
- (2) The audit of commercial undertakings of public bodies which are subject to compulsory audits.
- (3) The compulsory audit of insurance undertakings and building societies.

Furthermore the activities of auditors cover :—

- (4) The audit of the accounts of all other classes of undertakings

and special accounting work in connection with profit estimates and financing schemes.

- (5) The preparation of accounts and reporting thereon, preparation of opinions in connection with the computation of profit-earning capacity of a company and with the valuation of plant.

Publicly appointed approved auditors may also by virtue of the rules and regulations applying to the profession undertake the following classes of work apart from pure auditing :—

- (6) Advice on “ business economics,” organisation of accounts and system work.
- (7) Advice in connection with financial and credit matters, the preparation of opinions on borrowing capacity.
- (8) Advice on the formation, merger and reconstruction of companies and on liquidation problems in connection with bankruptcy and deeds of settlement.
- (9) Advice and representation in tax matters.
- (10) Trustee work, i.e. as trustee either in voluntary or compulsory compositions, in testamentary matters, in bankruptcy matters, in administration of estates or as trustee in the narrow sense of the word, e.g. as holder on behalf of the pledgor, &c.

The Board for publicly appointed approved auditors consists of persons drawn from the profession itself and from representative business organisations together with nominees of the Government of the Reich, of the Governments of the States and of associations representing the interests of municipalities, and certain representatives from the universities. It has the power to lay down rules having the force of law regarding the conduct of approved auditors in professional matters. The oath taken by approved auditors binds them not only to secrecy but also to carry out their duties “ without fear or favour.”

The approved auditors are subject to the supervision of the Chamber of Commerce where they are situated. A procedure has been designed to enable the appointment of an approved auditor to be withdrawn. The recognised professional body which looks after

the professional interests of publicly appointed approved auditors is the "Institut der Wirtschaftsprüfer" (Institute of Approved Auditors) in Berlin. Admission and examining boards are situated in 13 towns in Germany, viz.:—Berlin, Bremen, Breslau, Frankfurt, Hamburg, Cologne, Königsberg, Leipzig, Mannheim, Munich, Münster, Nürnberg and Stuttgart, and correspondingly the Institute has sub-committees in each of these towns which watch over the professional conduct of its members and arrange for lectures, &c., on subjects of interest to the profession. Attached to the Institute is a court of honour, which deals with cases of breaches of professional etiquette and ethics.

III.—STATUTORY FUNCTIONS OF APPROVED AUDITORS IN GERMANY

The main function of approved auditors, individuals as well as auditing companies, is the compulsory audit of public companies. In Section 262 (a) of the Decree of 19th September 1931, it is laid down that the annual accounts of a public company, as reflected by the books of the company and as amplified by the report of the management, are to be audited by one or more expert auditors before they are submitted to the general meeting for approval. Only approved auditors may be appointed "auditors" for this purpose. They are elected by the general meeting of the shareholders (Section 262 (b)), and the election should take place before the end of the financial year, failing which the local court is empowered to "appoint" an auditor. The management is bound by statute to issue to the auditor elected by the shareholders instructions to carry out the audit. Section 262 (c) lays down that persons over whom the company to be audited is in a position to exercise a material influence, may not be either elected or appointed auditors. Furthermore, neither members of the management nor of the board of supervision nor employees of the company may be elected or appointed auditors.

In Section 262 (d) it is laid down that the management must allow the auditors to inspect the books and documents of the company and must allow them to ascertain by physical inspection the amount of cash and investments and goods held by the company. The

auditors can demand from the management all explanations and evidence which a careful fulfilment of their duty to carry out an audit necessitates.

Section 262 (e) lays down that the auditors must make a written report on the result of their audit. In this report it must be particularly stated whether the system of bookkeeping, the annual accounts and the report of the management comply with the law, and whether the management has supplied the explanations and evidence demanded. The report is to be laid before the supervisory board. Each member of the supervisory board is entitled to see the report. The supervisory board in its comments on the report of the management must give the name of the approved auditor who carried out the audit and must include a statement commenting on the report of the auditor. Furthermore, information must be given in the general meeting which resolves upon the annual accounts as to whether the general findings of the audit gave rise to criticisms of a material nature or not.

Section 262 (f) deals with the certificate. If the result of the audit has been to confirm that there are no material objections to raise to the accounts as presented the auditors must state this in the form of a certificate to the accounts, in which the following must be stated :—

Whether after a conscientious audit based on the books and documents of the company and on the explanations and evidence supplied by the management the system of bookkeeping adopted, the annual accounts and the report of the management comply with the provisions of the law.

This certificate must be included in every publication of the accounts.

With regard to the duties of the auditors it is laid down in Section 262 (g) that auditors, and, where they employ other persons on an audit, these latter persons, are bound to conscientious and impartial auditing and to secrecy. They are prohibited from making use in an improper manner of commercial and technical secrets which they have learned in the course of their duties. Persons who contravene this obligation are liable to the company for any damages arising therefrom. The liability, however, is limited for each audit to

R.M. 100,000 in cases where merely negligence can be proved, even when several persons were engaged on the audit or several actions giving rise to a claim for damages have taken place.

IV.—THE AUDITOR'S RESPONSIBILITY

Sections 262 (f), dealing with the certificate, and 262 (g),² which define the principles for fixing the responsibility which an auditor has to accept for his work, are, of course, the most interesting sections to us in connection with the subject of my paper.

(a) *In relation to his certificate.* These legal provisions are intended to provide only the foundation of the building as it were ; the rules laid down are restricted therefore to a generalised statement of principles. This remark applies particularly to the certificate. In the earlier papers on this subject the wording of the certificate always played a large part. I regard it as dangerous to give too much weight to the wording. Our responsibility in auditing annual accounts is not a mere matter of form. Neither the wording of the law nor the wording of the certificate can be finally decisive in the matter. The essential point in connection with responsibility is the purpose of the audit and of the certificate. We should only regard the wording of the certificate as something which helps to express in words the purpose lying behind the introduction of compulsory audits as the main aim of the company law reform. Any such means that only helps to express something else must be imperfect. There is surely no one among us who would support without reserve the statement that any wording of certificates, which is to-day common, can express everything that there is to say. The wording of the certificate is a secondary matter. The fact that in discussing our responsibilities this matter has been pushed so much into the foreground, has often unfortunately given persons who are not well versed in these matters, the impression that our audit is either exclusively or at any rate predominantly a matter of pure formality.

Admittedly—and I make this remark in order to avoid misunderstanding—the importance of the statutory wording of the certificate should not be underestimated. I know that in individual

cases in practice it certainly has a very considerable importance. If we, however, wish to define our responsibility in a code of principles, we cannot cite the wording of the certificate as decisive, but rather that which lies behind this wording and should be expressed by it, that is to say, the purpose of the audit.

What does the German Decree of 19th September 1931, say in this matter? The provisions regarding the scope of the audit, the report and the certificate show clearly the goal which is aimed at. The auditor, as a person charged with the duty of assisting the supervisory board, must see to it that the management of the company has issued true accounts.

(b) *As compared with that of the management.* According to German company law the auditor occupies an auxiliary position only. In the first place, the management (having regard to its duty to carry on the business of the company) and the supervisory board (in view of its duty to supervise the company generally) bear the responsibility for the preparation of the accounts. The responsibility of the auditor is secondary to this. He is only responsible for the audit itself and not for the company and books to be audited. The auditor has not the same kind of responsibility for the annual accounts as the management; on the one hand, his responsibility is greater and on the other hand it is smaller than that of the management.

It is greater in two matters. Firstly the auditor, being a professional approved auditor, is an expert in accounting matters. Theoretical knowledge and practical experience in the relative accounting and legal fields of knowledge exceeding those expected generally of the management are required of him. He must do his work with the carefulness of a professional expert, and as a consequence he bears more responsibility than the non-expert, e.g. a member of the management. In another matter, too, the responsibility of the auditor for the annual accounts exceeds that of the management. In preparing accounts the management must and can in general rely on the material produced by its bookkeeping department, and this all the more seeing that it is to be examined by the auditor. The auditor, however, in view of his duty to audit,

must take responsibility for the regularity of the material upon which he works.

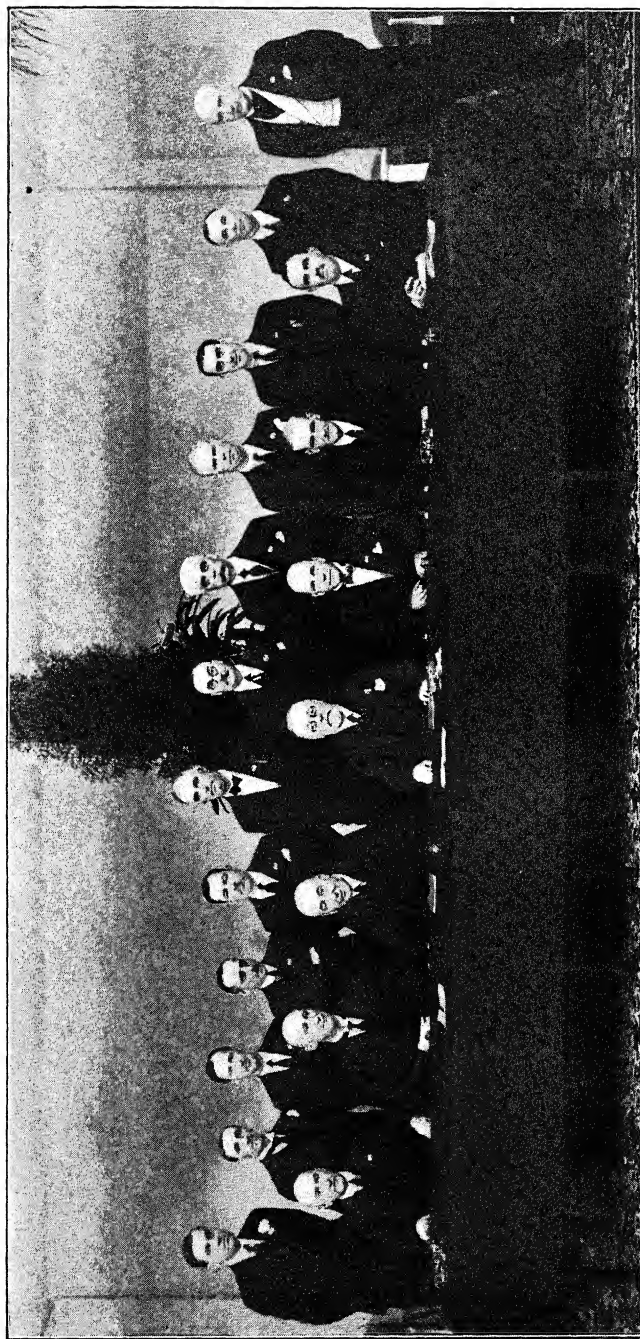
On the other hand, the responsibility of the latter may also be less than that of the management in certain cases. He is outside the undertaking and the conduct of its business. He cannot therefore know whether items which should have been booked have actually been taken up in the books. The auditor can also not accept an absolute warranty for the completeness of the annual accounts and of the material on which they are based. An auditor certainly must make use of his critical faculties in this direction, and in many cases by the exercise of care and of his expert knowledge he will be able to ascertain that the material on which the annual accounts are based is not complete and that all items have not been booked. But cases can easily arise in which the fact that material was missing could not have been ascertained by the auditor ; on the other hand, of course, the management in such cases would be open at least to the charge of culpable negligence and possibly of criminal conduct.

From the fact that the auditor is auxiliary to the supervisory board arises a further limitation of his responsibility for the annual accounts. He is naturally only responsible for the annual accounts which he has audited and certified, and it is immaterial to him what set of accounts is laid before the general meeting by the management and approved in general meeting. The work of the auditor ends with the issue of his certificate and with the report to the supervisory board. What the latter does with these documents is their business. They are responsible for them, not the auditor.

(c) *For the correctness of the accounts.* Having thus far dealt with the principles regarding the responsibility which the auditor bears arising out of his position as auxiliary to the supervisory board, we now turn to the deductions which are to be drawn from the fact that the auditor is responsible that the management adopts the principles of proper accounting.

Accounting is "proper" if it complies with the law and with such commercial practices as are in Germany within the law. The report of the management and the annual accounts (including the book-keeping) must comply with the provisions of the law and with the

THE EXECUTIVE COMMITTEE, LONDON, 1933



[Photo by Rawood

Standing (left to right) : R. W. Banks, C.B.E. (Assistant Secretary), F. Wilson, F.C.R.A., James Wood, C.A., Charles Reid, D.S.O., C.A., J. C. Burleigh, C.A., R. S. Stokes, F.C.A., T. Keens, F.S.A.A., William Cash, F.C.A., A. E. Cutforth, C.B.E., F.C.A., J. C. Latham, F.L.A.A., A. A. Garrett, F.C.I.S. (Assistant Secretary), Hon. George Colville, M.B.E. (Secretary).
Seated : H. F. Kemp, F.C.A., Sir Nicholas Waterhouse, K.B.E., F.C.A., Sir James Martin, M.B.E., F.S.A.A. (Vice-President of the Congress), Lord Plender, G.B.E., LL.D., F.C.A. (President of the Congress), H. L. H. Hill, F.C.A., Henry Morgan, F.S.A.A., E. Cassleton Elliott, F.S.A.A.

general principles of correct bookkeeping and preparation of balance sheets. German company law contains very detailed provisions in this regard, in particular for the annual accounts. The principles are given in Section 260 (b), subsection 2, which reads as follows :—

“ The annual accounts are to be drawn up so clearly and perspicuously that they provide the parties interested with as sure a view of the position of the company as possible.”

In Section 261 (see appendix) will be found the provisions regarding the valuation of important assets and liabilities. In Section 261 (a) (see appendix) the classification of the balance sheet and in Section 261 (c) (see appendix) the classification of the profit and loss account is laid down.

In German law, therefore, we have very detailed provisions aiming at balance sheet truth and balance sheet clarity. But neither the Government nor professional circles were ever in doubt that the power of the law is restricted to setting up standards only, that legal provisions cannot be devised which will secure an absolutely “ correct ” balance sheet. This is so for the following reasons :—

- (1) From their nature annual accounts must be incomplete. The transactions of a going concern, which in their totality commence with the formation of the undertaking and end with its liquidation, cannot be absolutely correctly expressed on any particular date in marks and pfennigs.
- (2) The undertaking is an economic whole ; it is only possible to give some sort of expression to its real value by resolving the individual transactions or the existing legal and economic rights and duties of the company into individual asset and individual liability items in the accounts, and showing its value as the sum of these assets less the liabilities.
- (3) There are important economic factors—for the financial position of the undertaking often the most important—which are not expressible in the accounting of the undertaking at all.
- (4) The law consists of regulations covering the general case. In the individual case very often matters peculiar to the special case in question (for instance, the class of trade, the

size of the undertaking, the relationship to other concerns) are of decisive importance, and account must be taken of such exceptions to the general rule, if the accounts are to be clear and true.

There can therefore be no absolutely correct annual accounts and there are good reasons for the fact that even experts, basing themselves on a similar set of facts, can come to entirely different annual accounts and that each expert could perfectly justifiably describe his annual accounts as clear and true.

Recognising this the law has not gone further than to lay down the goal that is to be aimed at (Section 262 (b)) :—The annual accounts must be clear and true. The law has indeed in a few matters set up rigid rules of valuation, but for the rest it has confined itself to laying down rules covering the general case. It has allowed the necessary latitude to conscientious opinion in preparing annual accounts within the limits of these rules.

This applies in particular to the persons responsible for the preparation of the annual accounts, but it also applies from the nature of the case to the auditor. He can only object to the annual accounts when the management has not kept within the permissible degree of latitude ; but then he is compelled to register his objections.

We can never under any circumstances undertake to warrant that the annual accounts are absolutely correct, but only that they comply with the provisions of the law. This finds clear and unambiguous expression in the form of certificate as it is prescribed in German company law. This certificate confirms that the requirements of the law have been satisfied. It does not certify, for instance, that the annual accounts show absolutely correctly the assets or the profit or the loss. Everyone of us will probably think of the delicate subject of secret reserves. If secret reserves exist, the balance sheet in general does not show the real financial position of the company, and consequently an auditor cannot give a certificate that the accounts are absolutely correct. But he can confirm that it complies with the requirements of the law, since secret reserves are in principle allowed by the law.

Although the law allows a certain latitude to the judgment of the

persons preparing the annual accounts, it does not thereby, of course, open the door wide to arbitrary conduct. This rule applies in the first place to the management in the preparation of the annual accounts. The management has not an entirely free hand, but is bound by the general rules of conduct applicable to business men. This rule applies still more to the auditor. Not the least important of the functions with which he has been endowed by law is the duty of determining where latitude of judgment ends and arbitrary conduct begins. The auditor is not an executive of the company, he is not part of the management, he is responsible to the company as an entity and he stands outside any conflict of interests between the management and the shareholders. He can and must see to it that the annual accounts, within the latitude allowed by the law, are prepared as accurately as possible. This finds also expression in the law. Our certificate begins with the words "After a conscientious audit." It is well known that in the discussions which preceded the framing of the Decree this expression was inserted to make clear on the one hand that the auditor cannot guarantee an absolute correctness of the accounts, seeing that his findings are naturally based on his own judgment, and on the other hand that the audit has been carried out, following the words of Section 262 (g), "carefully and impartially" as is shown by the employment of the word "conscientious." Thus we accept with our certificate the responsibility for the real correctness of the annual accounts, without, of course, excluding in any way the necessary latitude of judgment.

(d) *In relation to the interests of the company and of the State.* This duty of ensuring that the accounts are as "fair" as possible does not stand alone, however, without relation to other factors as if it were in a vacuum. It definitely depends on certain factors. The auditor must not, of course, let himself be influenced by the private interests of the management or of the supervisory board or of a shareholder or group of shareholders, not to mention by his own private interests. What must govern his conduct are interests which reach further, namely, those of the company and of the general public. That the interests of the company have very great weight, always of course within the limits of the law, is obvious from

the fact that he is responsible to the company for his work. He is liable to the company directly for damages which he causes by improperly carrying out his duties (Section 262 (g)). Moreover, the interests of the company are expressly mentioned in the law. In one important case the interests of the company are regarded as taking precedence over the legal regulations. In Section 260, subsection 4, it is laid down that information that ought otherwise to appear in the annual report can be omitted if the overriding interest of the company demands it.

In this section mention is also made of the overriding interest of the public. This also takes precedence over the compulsion to give information and must be observed not only by the management but also by the auditor. As I have said, this section only applies to the report, not to the annual accounts, and its position with the law indicates that it is only to be taken as a hint. But I regard it as very probable that the coming Company Law will place the interests of the company, and above all those of the State, very much more strongly in the foreground, and will make these interests the deciding factor in the question whether the annual accounts comply with the legal requirements for the purpose of giving the certificate.

(e) *Summary.* I should like to summarize the principles I have enunciated as follows :—

- (1) The determining factor in the question of responsibility is the purpose of the audit and of the certificate.
- (2) As auxiliary of the supervisory board, the auditor must satisfy himself that the management keeps and has presented proper accounts.
- (3) The auditor bears partly a larger, partly a smaller responsibility for the annual accounts than the management.
- (4) He cannot guarantee the absolute correctness of the annual accounts.
- (5) In passing on the annual accounts which are prepared the auditor must be allowed a certain latitude of judgment.
- (6) The auditor cannot accept an absolute guarantee that material (books, letters and other sources of information)

has not been suppressed and that therefore the annual accounts are not defective.

- (7) But he is responsible that the annual accounts comply with legal requirements.
- (8) He has to guarantee that the annual accounts are really correct, that is to say, that within the latitude allowed by the law, they are as correct as they possibly can be.

V.—CONCLUSIONS

The principles that I have enunciated show the extent to which the limits of our responsibility, upwards and downwards, are determined. I should like in this connection to emphasise one point which is really self-evident, but must always be brought out strongly, viz. :—that the very purpose of the audit and of the certificate make it clear that the audit required is not merely a formal one, i.e. that the figures in the ledger correspond with the figures in the annual accounts, but that it must be an audit of the books and underlying documents. The Decree mentions this specifically in Section 262 (a), subsection 2.

It is difficult to define comprehensively in a few words the limits of such an audit. In my view one can only say that the principle by which an approved auditor must be guided is that he has got to pursue his investigations until he can conscientiously satisfy himself that, exercising all his skill and after most careful consideration, he can give a certificate for the annual accounts. The degree of skill required in our case is a special one : it is the degree of skill required of the professional expert and it exceeds the degree of skill demanded of the ordinary business man. It is expected of an auditor that he should display that amount of practical and theoretical knowledge and of experience in his work that a member of our profession in view of the developments in accounting must to-day have. This principle applies more particularly to answering one of the most doubtful points but nevertheless one of the most important points in our subject.

In nearly all the usual certificates and also in the German form of certificate we find mention made of the books and documents, i.e. the material on which the preparation of the annual accounts is based.

This common restriction of the certificate is specially designed to bring out, as I have already mentioned, that an absolute guarantee for the completeness of the books in particular cannot be accepted. Even where the auditor has exercised the highest degree of skill it will be impossible for him in many cases to ascertain whether all transactions which should have been booked have actually been booked. In such cases he must exercise the professional skill of the expert auditor who must form for himself a clear view on the matter by the employment of his critical faculties upon the material supplied.

Finally I should like to answer the question shortly, to whom is the auditor responsible ?

I have already stated that according to Company Law he is directly responsible to the company and particularly for the damages which the company suffers because he has neglected his duties. This liability is unlimited in the case of intentional wrong-doing, and is limited where the wrong-doing is negligent to R.M. 100,000 for each audit. As far as Company Law is concerned, therefore, the auditor is only liable to the company, not, however, to its executives and not to third parties, such as, for instance, creditors or shareholders. Of course, in certain cases the question of criminal liability to third parties might arise under the general principles of common law.

In professional circles, however, we are all conscious that the moral responsibility goes far beyond this purely legal responsibility and that we are responsible not only to the company but also to its executives, to the shareholders, to creditors and to the public. We owe this sense of moral responsibility as a duty to our profession which can only attain a standing corresponding to the tasks laid on it when it is dominated by a consciousness of responsibility that is not merely defined and limited by legal regulations.

I have several times emphasised that our responsibility is not least of all determined by the interests of the public. I have pointed out that in the present Decree hints in this direction exist and that the coming Law in Germany will probably lay down definite rules in this connection. There is no doubt that in the National and Social

State our profession must fit its activities into the common weal and carry out its tasks to the benefit of this State.

APPENDIX

EXTRACTS FROM THE GERMAN COMMERCIAL CODE

SECTION 260

(1) The general meeting shall resolve on the annual balance sheet and profit and loss account (annual accounts), on the distribution of profit and on the discharge of the management and the supervisory board from liability for their conduct of the business.

(2) The management must submit the annual accounts and a report to the supervisory board and must present these documents together with the comments of the supervisory board on the report of the management to the general meeting in the first three months of a financial year for the immediately preceding financial year. The statutes may provide for a longer period than three months, but the period shall not exceed six months.

SECTION 261

The following rules apply to the valuation of the individual items in the annual balance sheet :—

- (1) Fixed assets and other assets which are intended to be used permanently in the business of the company may be stated at the cost of acquisition or at the cost of production without regard to the fact that they have a smaller intrinsic worth, provided that the proportion of loss of value corresponding to the ratio between the period covered by the annual accounts and the period of probable useful life of the asset in question, is deducted from the figure at which the asset stands in the balance sheet or is carried in a depreciation account. In computing the cost of production a reasonable amount of depreciation and a reasonable proportion of the factory and administrative costs, corresponding to the time required for the production, may be added ; selling costs, however, may not be treated as factory or administrative costs for this purpose.

Investments which are intended to form a permanent part of the company's property, may be stated at the cost of acquisition without regard to the fact that they have a smaller intrinsic worth, provided that the general principles of honest accounting would not necessitate their being written down.

- (2) Investments and other assets which are not intended to be retained as such as part of the company's property permanently, including goods for sale and own shares held by the company may be stated either at the cost of acquisition or at the cost of production. In computing the cost of production regard may be had to the second sentence of the first subsection of 1.

If the cost of acquisition or of production of an asset exceeds the market (or stock exchange) value on the date of the balance sheet, the asset may not be stated at a figure in excess of this latter value.

If, in cases where a market value is not ascertainable, the cost of acquisition or of production of an asset exceeds the value that may fairly be placed on it, the asset may not be stated at a figure in excess of this latter value.

- (3) The expenses of the formation of the company and of increasing its capital may not be shown as assets.
- (4) An asset may not be shown representing the goodwill attaching to the business. Where, however, the consideration given for the acquisition of an undertaking exceeded the value of the individual assets composing the undertaking at the time it was acquired, the difference may be shown as a separate item on the assets side of the balance sheet. The asset must be amortised in yearly annual instalments which must be reasonable having regard to the circumstances of the case.
- (5) Loans granted to the company must be shown under the liabilities at the amount which is repayable. If this amount exceeds the sum received when the loan was granted, the difference may be shown as a separate item on the assets

side of the balance sheet. The asset must be amortised by yearly instalments which may be spread over the whole period of the loan.

- (6) The amount of subscribed capital must be shown as a liability at its full nominal amount.

SECTION 261 (a)

(1) The following items must be shown separately in the annual balance sheet, so far as the nature of the business does not necessitate a different classification ; a more detailed classification, however, is permissible :—

A.—ASSETS

I. Unpaid and uncalled capital.

II. Fixed assets :—

(1) Land.

(2) Buildings—

(a) office buildings and dwelling houses ;

(b) factory buildings and other structures.

(3) Machinery and fixtures.

(4) Tools, factory and office furniture and furnishings.

(5) Concessions, patents, licences, trade-marks and rights of a similar character.

III. Holdings in other companies. In case of doubt a shareholding in a company which is equal to or exceeds one-fourth part of the capital of that company is to be regarded as a holding.

IV. Current assets :—

(1) Raw materials and operating supplies.

(2) Processed goods.

(3) Finished goods.

(4) Investments and securities held, provided that they do not fall under III, IV, Nos. 5, 11 or 12.

(5) Own shares belonging to the company (the nominal amount of these shares must be indicated).

(6) Mortgages and land-charges held by the company.

(7) Payments in advance effected by the company.

(8) Debts due for deliveries of goods or services rendered.

- (9) Debts due by subsidiary companies and by companies in the same group.
 - (10) Debts due by members of the management or by a member of the management of a subsidiary company or of a company of which the company whose balance sheet is presented is itself a subsidiary or by the wife or children of such a member of a management or by any third party for account of such persons.
 - (11) Bills receivable.
 - (12) Cheques.
 - (13) Cash on hand including credit balances with banks having the right of note-issue and with the postal authorities.
 - (14) Credit balances with other banks.
- V. Items in suspense deferred to the following year.

LIABILITIES

- I. Subscribed capital, the total nominal amount of preference shares of each series must be shown separately ; if a class (series) of shares has been issued endowed with voting rights exceeding those of other classes (series) denomination for denomination or where one class (series) of shares has voting rights in proportion to its denomination not corresponding with the voting rights attaching to the denomination of other classes (series) of shares, the total voting power of the thus preferred shares and of the non-preferred shares must be indicated.
- II. Reserve funds :—
 - (1) Statutory reserve funds.
 - (2) Other reserve funds.
- III. Reserves.
- IV. Depreciation reserves.
- V. Creditors.
 - (1) Loans taken up by the company (if secured by a land-charge, this must be indicated).

- (2) Charges resting on the land belonging to the company, so far as they are not merely charges to secure the payment of a debt or in connection with loans taken up by the company.
- (3) Prepayments of customers.
- (4) Liabilities in respect of goods supplied or services received. •
- (5) Liabilities to subsidiary companies or to companies within the same group.
- (6) Bills payable.
- (7) Liabilities to banks.

VI. Suspense items deferred to the following year.

(2) The profit or loss for the year must be shown in one figure as the last item of the balance sheet and must be segregated from the profit or loss carried forward from the previous year.

(3) In the case of fixed assets and holdings in other companies increases or decreases in respect of each balance sheet item must be shown separately. Debts due to the company may not be set off against debts due by the company; similarly charges on land, so far as they are not legally classifiable as debts due by the company, may not be set off against the asset representing the value of the land itself. Items which are classifiable as reserve funds, reserves or depreciation reserves must not be included among the creditors of the company. If debts due to or by the company could be classified under several items, a note must be made to the item under which they are shown that they could be classified otherwise, if this is necessary in order to set forth the position clearly and perspicuously. Own shares of the company held by it may not be shown under other items.

SECTION 261 (c)

(1) The following items must be shown separately in the profit and loss account, so far as the nature of the business does not necessitate a different classification; a more detailed classification is, however, permissible :—

I. Expenditure :—

- (1) Salaries and wages.

- (2) Social services.
- (3) Depreciation of fixed assets.
- (4) Other amounts written off.
- (5) Interest paid (but only to the extent that it exceeds interest received).
- (6) Taxes on the property and income of the company.
- (7) All other expenditure except the cost of raw materials and operating supplies or, in the case of a merchandising business, the cost of goods purchased.

II. Income :—

- (1) The balance of income after deducting the cost of raw materials and operating supplies or, in the case of a merchandising business, the cost of goods purchased and after deducting the items which are to be shown separately under Nos. 2-5 below.
 - (2) Income from holdings in subsidiaries.
 - (3) Interest receivable (but only to the extent that it exceeds interest paid) and other income from investments.
 - (4) Special income.
 - (5) Extraordinary receipts.
- (2) The profit or loss for the year must be shown in one figure as the last item of the profit and loss account and must be segregated from the profit or loss carried forward from the previous year.

THE AUDITOR'S RESPONSIBILITY IN RELATION
TO BALANCE SHEETS AND PROFIT
AND LOSS ACCOUNTS
THE AMERICAN POINT OF VIEW

BY

ROBERT H. MONTGOMERY, C.P.A.

During the last few years, in the United States, the whole question of the auditor's legal responsibility has been discussed at such great length and in such detail that one might think that we have been confronted with a new problem. However, instead of it being a new problem it is as old as the profession itself. We have nothing new to report because there has been no change whatever in our legal responsibilities.

Our problem embraces four major considerations :

- (1) To what extent is an auditor liable to a client for negligence.
- (2) The scope of employment as affecting liability to clients.
- (3) The proposition that an auditor may be liable to third parties for negligence.
- (4) When gross negligence is so great as to be fraudulent and thereby create liabilities to third parties.

I

TO WHAT EXTENT IS AN AUDITOR LIABLE TO A CLIENT FOR
NEGLECT

The profession of public accounting in the United States is about fifty years old. When it started it automatically became subject to a principle of common law which had been in force in the United States for at least 100 years and much longer in Great Britain. The rule at that time and at the present time is that one who holds himself out as an auditor for hire represents that he is capable of performing such work in a skilful manner ; and if he fails to do so, he is liable to his client for loss sustained by reason of his negligence. It is

not a rule which can be covered by specifications. There are certain logical modifications and limitations but each case of alleged negligence differs in its facts from every other case so that what may be held to be negligence in one case may be excusable in another.

We all agree that where there is negligence, there is liability to clients. The following definition of negligence is quoted from *Railroad Co. v. Jones*, 95 U.S. 439-441 :

"Negligence is the failure to do what a reasonable and prudent person would ordinarily have done under the circumstances of the situation, or doing what such a person under the existing circumstances would not have done."

If in certain matters the auditor falls short of his real duty, it may be because, in all good faith, he holds a mistaken belief as to what that duty is. The auditor may conduct the audit honestly and carefully within the scope he understands it to cover. He may make an error of judgment, an error of judgment which may be the direct or proximate cause of disaster.

Usually the auditor makes tests to determine the accuracy or sufficiency of the record. Much depends on these tests.

In the *Ultramares* case (hereinafter referred to at more length) the Court of Appeals of the State of New York (the highest court having jurisdiction) considered the work usually performed by auditors. The following is quoted from Judge Cardozo's opinion :—

"Care should of course be taken to conduct the tests in such a way as to obtain the maximum assurance of regularity from the work done. Care should also be taken to indicate in reports and in certificates when the test-checking procedure is used, as distinguished from complete verification. A statement to this effect not only affords protection to the accountant but it enables the person who reads the report or reviews the statement to know what was done, and, therefore, to draw his own conclusions with respect to the soundness of the basis on which the accountant formulated his opinion."

If the auditor offers his services in a calling that requires peculiar skill, he is understood to possess the degree of skill that is common in that particular calling. If he fails to possess that skill he will be

liable to his client for resulting damages. As was said by a New York Court, in *Smith v. London Assurance Corp.*, 109 App. Div. (N.Y.) 889 (1905):

"The plaintiffs do not challenge the proposition of law advanced by the defendant that public accountants now constitute a skilled professional class and are subject generally to the same rules of liability for negligence in the practice of their profession as are members of other skilled professions, and such is doubtless the law."

II

THE SCOPE OF EMPLOYMENT AS AFFECTING LIABILITY TO CLIENTS

In determining whether or not an auditor has been guilty of negligence, it is necessary to consider specifically what he was employed to do. A client cannot expect a detailed audit where the auditor was engaged to make merely a balance sheet audit. The auditor should be careful, however, to obtain definite written instructions to which he can refer and to limit his statements and certificates to the matters of which he has actual knowledge.

Sometimes after a balance-sheet audit, specifically requested in writing, has been made and the report rendered, it is discovered that petty defalcations have been going on for a long time. It is natural for the client, in such a case, to criticize the auditor, but if the latter has specific instructions to which he can refer, he can clearly show that the detection of the small theft was not within the scope of the audit.

The scope of the employment cannot be determined simply from the compensation paid, though in a doubtful case the amount of compensation would be some evidence of the character of the employment. An auditor may undertake to perform for one hundred dollars work for which the reasonable compensation is one thousand dollars. He will nevertheless be held to have agreed to exercise the skill of his calling in the work which he agreed to do.

In some cases, clients may be shown to have caused the damage in question by their own carelessness. If the proximate cause of the loss was the negligence of the client's own officers or employees, the

auditor should be freed from liability, following the accepted principles of law.

Damages to Clients for Negligence

The damages, to which a client is entitled by reason of the auditor negligently performing his contract, will depend largely upon the facts of the particular case. There is no doubt that if the auditor negligently performs his duty the client is entitled to recover back whatever fees he has paid the auditor. Whether or not the consequential damage arising out of the auditor's neglect, should also be included as an item in the client's recovery, is a more difficult question. Many courts feel that it is not sufficient that the auditor's neglect was the proximate cause of the client's loss, but it is also necessary for the client to prove that it was reasonably foreseeable that neglect would cause such a loss before a recovery for consequential damages can be had. This view is well expressed in a decision from the highest court of one of our western states in *City of East Grand Forks v Steele*, 121 Minn. 296, 45 L.R.A. (N.S.) 205 (1913).

This was an action to recover (first) the fees paid the auditor by the client, and (second) damages arising from the negligence of the auditor. The subject of privity of contract was, therefore, not in question, because the employment was direct. The city was allowed to recover back the amount paid by it to the defendant for the services which were held to have been performed negligently in that they failed to discover embezzlements which had been occurring prior to and continued to occur subsequent to the audit. The demand for damages, however, was denied. Chief Justice Taylor remarked :

“ Defendants represented themselves as expert accountants, which implied that they were skilled in that class of work. In accepting employment as expert accountants, they undertook, and the plaintiff had the right to expect, that in the performance of their duties they would exercise the average ability and skill of those engaged in that branch of skilled labour. They were employed to ascertain, among other things, whether any irregularities had occurred in the financial transactions of the

city clerk, and, if so, the nature and extent of such irregularities. If, from want of proper skill, or from negligence, they did not disclose the true situation, they failed to perform the duty which they had assumed, and failed to earn the compensation which plaintiff had agreed to pay them for the proper performance of such duty.

“ The work of an expert accountant is of such technical character and requires such peculiar skill that the ordinary person cannot be expected to know whether he performs his duties properly or otherwise, but must rely upon his report as to the thoroughness and accuracy of his work. The full contract price having been paid in the belief, induced by defendant's report, that such report disclosed fully and accurately the condition of the city's accounts, the city is entitled to recover back the amounts so paid, upon proving that, through the incompetence or the negligence of defendants, the report was in substance misleading and false.

“ . . . The damages claimed on account of the losses resulting from the defalcations of the clerk and the insolvency of his surety are too remote to be recovered, without showing the existence of special circumstances, known to defendants, from which they ought to have known that such losses were likely to result from a failure to disclose the true condition of affairs. Such losses are neither the natural nor the proximate consequences of the failure of defendants to make a proper audit. Neither are any facts shown from which it may be inferred that a loss from either of these causes was or ought to have been contemplated, when the contract was made, as likely to result from a breach of duty on the part of defendants.

“ If at the making of the contract and in the light of the knowledge then possessed by them, the parties had taken thought as to what consequences might reasonably be expected to result from its breach, there is nothing set forth in the complaint from which we can say that they ought to have foreseen or to have contemplated that the clerk was likely to commit a crime, or that his surety was likely to become bankrupt, and

thereby entail financial loss upon the city. There may be circumstances under which the negligence of an expert accountant may make him liable for losses, as where he is employed to determine the amount that should be exacted from a surety for the default of his principal ; but the facts alleged in the complaint do not bring this case within any such rule.”

III

THE PROPOSITION THAT AN AUDITOR MAY BE LIABLE TO THIRD PARTIES FOR NEGLIGENCE

It is a dangerous and far-reaching doctrine that an auditor or any professional man may be held responsible in damages for honest blunders to one who has not employed him, when there has been no privity of contract or direct relationship. If such an extension of responsibility should be made it would so expand the entire field of liability for negligence as to make it nearly, if not quite, co-extensive with that of liability for fraud. A change so revolutionary, if expedient, and if justified by current demands for higher standards of speech and conduct, must be wrought by legislation.

Auditors are not insurers. This is obvious and I shall not discuss it.

No American case has been found holding an auditor liable for damages for negligently performing his services where there was no privity of contract or duty. In other words, to date we find no authority for allowing a third party to whom a financial statement has been shown to rely (contractually) upon the auditor's certificate. There must be either privity of contract or some relationship akin to that of contract.

What some believe to be an important departure from the rule is that announced by a court in the United States in which it was intimated that negligence may be so gross that automatically a doubt arises regarding the *bona fides* of the auditor's certificate. The case in question is the *Ultramares* case, 255 N.Y. 88, 174 N.E. 441 (1931). This was an action in tort for damages suffered through misrepresentations made by defendants. There were two causes of action : One for negligent misrepresentations and one for fraudulent misrepresentations.

One Stern & Co. employed the defendants, public accountants, to audit its books and to prepare a balance sheet. The defendants certified the balance sheet, presumably knowing that the statement was to be used by Stern to represent its financial condition in order to secure loans. There was, however, no specific mention of the plaintiffs, by name or other description. The balance sheet was negligently prepared, showing the firm to be financially sound when in fact it was insolvent. The books of the company had been falsified to set forth fictitious accounts receivable, and these fictitious accounts had not been discovered ; or when discovered the explanations given the auditors by their client relative thereto were false ; and, as well, various accounts receivable had been pledged simultaneously at three or four different banks, which fact was not mentioned if discovered. In short, the balance sheet did not present a correct and true picture of Stern & Co.'s condition. Plaintiffs claimed to have extended credit on the strength of the statement certified by the defendants with resulting loss. The trial judge dismissed the cause of action for fraud and granted the defendants' motion to dismiss the action for negligence after the jury had returned a verdict for the plaintiffs. In other words the jury found the defendants guilty of negligence and responsible in damages to the plaintiffs who were third parties, but the trial judge dismissed the action on the ground that the defendants could not be held responsible to such third parties in damages for negligence.

The Appellate Division (an appellate tribunal intermediate the trial court and the highest court of the State) affirmed the trial judge's decision as to the cause of action for fraud and reversed the decision as to the cause of action for negligence, relying principally on the case of *Glanzer v. Shepard*, 233 N.Y. 236, 135 N.E. 275 (1922), a case involving a certificate of a public weigher rather than an auditor. In other words, holding as the jury did—that the defendants were guilty of negligence and responsible in damages to the plaintiffs (third parties).

The Court of Appeals (the highest court of the State) reversed the Appellate Division on both causes of action, holding that the defendants owed not only to the employer but to prospective

creditors and investors a duty to make their report without fraud, since the circumstances showed that the balance sheet and auditor's certificate would be exhibited to such persons, but stating that there was no liability to creditors or investors (where no privity of contract existed) merely for negligence.

In rendering the opinion of the Court of Appeals, Chief Judge Cardozo stated: "The defendants owed to their employer a duty imposed by law to make their certificate without fraud, and a duty growing out of contract to make it with the care and caution proper to their calling." The court further pointed out that if a duty to avoid being negligent with respect to creditors or investors were to be imposed, a thoughtless slip or blunder might expose accountants to a liability in an indeterminate amount, for an indeterminate time, to an indeterminate class. The court thought that this was too great a responsibility to impose upon the business of public accountancy; that the earlier decisions did not establish such a liability; and that creating such a duty would be too violent a legislative innovation for a court to make. In awarding a new trial to plaintiff on the fraud action, the court held that by the nature of their calling, public accountants profess to speak with knowledge in certifying a balance sheet, and that in this case a jury could well have found that the defendants had misrepresented their knowledge. The case, therefore, was sent back for a new trial on the fraud issue to determine whether the statement of opinion in the certificate that the balance sheet presented a correct view of the financial condition of Stern & Co. had been based on such flimsy grounds and such an absence of actual knowledge as to constitute fraud. The case was not retried, having been settled out of court.

The truth of the matter is that the service of the auditor chiefly consists of rendering an opinion. The opinion is based upon investigation and analysis, nevertheless it is still an opinion. If persons not directly concerned in the arrangement made by the auditor and his client suffer loss because they depended upon the opinion of the auditor, it is unfortunate for them. Nevertheless the fact remains that they are third parties. We cannot ignore the practical element which is that if auditors are to be responsible to

the world, they will have to increase their fees, since fees depend in part on risks assumed.

The opinion of an auditor, however, as expressed in his certificate or otherwise does not expose him to liability beyond that growing out of his direct relationship to his client unless he has no genuine belief in his own statement or there has been such reckless misstatement or insincere profession of an opinion as to bring his act within the category of fraud. In other words, if he does his work and expresses his opinion honestly he will not be held responsible to third parties for mere blunders or mistakes of judgment.

Honest error is not always avoidable in human affairs but under a logical interpretation of the decision of the lower court in the *Ultramares* case, honest error would have made all the world forever a potential creditor of the practitioner of any profession. In that case, the auditor contended that where there is no privity of contract there can be no liability for negligence of the practitioner or his staff. In the highest court this contention prevailed. He is liable to his client and under certain very restrictive circumstances to one for whom he knows his work is intended. Except in case of fraud, he is not liable to strangers. Responsibility of auditors must be the same as that of other professional men. Auditors should not be exposed to liability to third parties "in an indeterminate amount, for an indeterminate time as to an indeterminate class."

The foregoing is somewhat mercenary and represents an attitude of which we cannot be proud. But the cold fact stares us in the face that if auditors are to be liable to all persons into whose hands a copy of the documents delivered to clients may come, the financial responsibility incurred would be beyond the means of any firm of auditors to meet. The professional opinion of auditors should not carry any such obligation.

Let us examine what constitutes privity of contract. How much knowledge is necessary on the part of an auditor to make him liable to a third, non-contracting, person? Suppose a prospective or actual client comes to an auditor and says that he wants financial statements to show to 20 banks for the purpose of floating loans ;

would such a state of facts give rise to a direct or contractual relationship with each of the 20 banks ? At the present time—no. If there is a change it may come from the conduct of auditors themselves. Taking auditors at their word when they claim to be of value to credit grantors, any considerable number of cases of losses to third parties, because of negligence in the making of statements or giving of certificates upon which such third parties rely, might lead to a modification of the present limitation on the liability to third parties.

The *Ultramares* case aroused great interest in the United States, particularly among the younger generation of auditors and lawyers. The following is a clearly stated criticism of the Court of Appeals of the State of New York for failing to hold the defendants in the *Ultramares* case liable on the cause of action for negligence. This appeared in a note in 19 *California Law Review* 454 (1930) at page 456 :

“ The defendants' business was of a semi-public character and they knew that investors and creditors would rely on their certificates. A duty of ordinary care would not seem to be too great an extension of liability, for the jury would consider the severity of the penalty in arriving at its verdict. An accountant in making an audit owes a moral duty not merely to the client who retains him, but to all those whom he contemplates as invited to act on the faith of his certificate. This report was made for the purpose of giving information for influencing moneylenders and investors. Should not the moral duty to furnish correct information be recognised as a legal duty ? Should the responsibility extend only to those extreme defaults that can be classed as fraud, or should there not also be responsibility for those less serious defaults classed as negligence ? The court in the principal case (*Ultramares*) decided against the broader liability by more or less arbitrary limitation of the doctrine of *Glanzer v. Shepard* . . . ”

The following is another comment on the *Ultramares* case which appeared in 16 *Cornell Law Quarterly* 419, at pages 425, 426 (1930) :

“ The decision in the principal case seems to limit liability for negligent verbal representations to three classes of cases :

“(1) Where there is such a privity of contract between the plaintiff and the defendant that the former is led to believe that he is one of those persons specifically invited to rely upon the representation of the defendant.

“(2) Where the representation is made by a person engaged in a public calling (liability here having been imposed thus far only upon notaries).

“(3) Where the representation is made in reference to an article inherently or imminently dangerous to life or limb.

“The court in the principal case was faced with the question of whether the rule imposing liability for negligent misrepresentations had reached its ultimate limit of social usefulness. On the one hand, there was the benefit to society from holding public accountants liable for negligent errors ; on the other, was the possibility that the imposition of such an extensive and indeterminate burden might limit the activities of accountants and thereby deprive society of a substantial part of their services. The court seems to feel that the latter consideration is the more important and, therefore, placed a definite limit on the development of the rule imposing liability for negligence . . .

“It is true that to extend the liability of the defendants in the principal case to a ‘multitude of possible investors’ might well be socially undesirable at the present time. It would seem, then, that although the decision on this point in the instant case follows logically from the interpretation placed upon *Glanzer v. Shepard* . . . yet had the court so desired it could have reached the opposite decision by placing a slightly more liberal, and apparently logical interpretation upon the previous cases. The real basis for the decision seems to be that the court believed that the rule imposing liability for negligent misrepresentations had reached its ultimate limit of social usefulness.”

I am not unmindful that frequently the auditor, before undertaking his work, is on notice (in many cases direct notice from credit grantors) that copies of his report and findings will be furnished to and relied upon by credit grantors. Can he say that he does not

want his work to be relied upon or can he say that if relied upon and the credit grantor suffers a loss he will claim immunity from money responsibility on the ground that he had no direct relationship with the credit grantor? Nine times out of ten, an auditor knows the precise purpose of the audit. In ten cases out of ten, if he does not know, he inquires—for it assists him in the form, the preparation, and the amount of details that he incorporates in his report. It should definitely be understood that, when credit grantors are instrumental in bringing borrowers and auditors together, the credit grantor has a high degree of protection in that the auditor's moral responsibility and professional standing are at stake, and that if the auditor is guilty of negligence the loss of prestige constitutes heavy punishment, which should satisfy the credit grantor. I repeat that the auditor is not an insurer.

To hold the auditor responsible to third parties in money damages is too extreme a doctrine under present conditions.

IV

WHEN GROSS NEGLIGENCE IS SO GREAT AS TO BE FRAUDULENT AND THEREBY CREATE LIABILITIES TO THIRD PARTIES

The legal responsibility of an auditor to persons other than the parties to his contract of employment necessarily rests not upon contract principles but upon principles of tort law.

As has been heretofore stated, negligence does not, of itself, render an auditor liable to third parties. Negligence may be so gross, however, as to constitute evidence of fraud or to be itself fraudulent.

With respect to an action based upon fraud, certain essential elements are required. There must be a false representation of a material fact, which was known to be false by the party making it, or else recklessly made; the misrepresentation must be made with intent to deceive and for the purpose of inducing the other party to act upon it; the other party must in fact have relied on it to his injury or damage. *Farrar v. Churchill*, 135 U.S. 609.

The broadest classification of fraud, and one which is essential to a complete understanding of an auditor's liability arising out of his

verification is actual fraud and constructive fraud. To constitute actual fraud there must be an intentional deception. Such cases do not furnish a very grave problem to an auditor. Constructive fraud covers the cases where a wilfully false representation is presumed from the circumstances of the transactions and the situation of the parties, and where a fraudulent intent may be imputed or inferred on the theory that one must be presumed to have intended the necessary consequences of his own voluntary acts. Such a situation is, for example, where a person who is in a position to know the truth makes a representation as to a material matter which is untrue. In such cases the intent to deceive may be found from the fact that the representation was false without further proof of actual intent. Moreover, the intent is regarded as conclusively proved and a finding that there was no such intent will be disregarded.

Consequently if a person making a false statement had shut his eyes to the facts or purposely abstained from inquiring into them, it would be held that he had no honest belief in their truth and was just as fraudulent as if he had knowingly stated that which was false. This rule was first definitely enunciated by Lord Herschell in the British Courts in *Derry v. Peek* (14 App. Cas. 337), which case involved a stock prospectus issued by directors of a company. Such a rule has been followed in general by most American jurisdictions.

In the *Ultramares* case it was to determine whether or not the auditors or their agents had so closed their eyes to the facts as not to have an honest belief in their truth that the Court of Appeals sent the case back for a new trial. Judge Cardozo's position was that when the certificate on the balance sheet states that the figures in the balance sheet are in accord with the books, it is not merely a statement of opinion, but is a statement of fact which the auditors assert to be true. Judge Cardozo further amplifies this by saying that it is not sufficient that there is a correspondence between the balance sheet and the general ledger. The correspondence to be of any moment "may not unreasonably be held to signify a correspondence between the statement and the books of original entry, the books taken as a whole. If that is what the certificate means, a

jury could find that the correspondence did not exist and that the defendants signed the certificates without knowing it to exist and even without reasonable grounds for belief in its existence."

The United States Supreme Court in *Lehigh Zinc & Iron Co. v. Bamford*, 150 U.S. 665, held that if statements of fact are made "for the purpose of their being acted upon and they relate to matters which he is bound to know, or is presumed to know, his actual knowledge of them being untrue is not essential." This language refers, of course, to fraud actions and Judge Cardozo cites this Supreme Court case in support of his position that a jury would be warranted in finding fraud because of the statement "in accord with the books" used by the auditors in the *Ultramares* case.

Thus the theory of liability for fraud has been gradually expanding. From the originally strict requirement that there must be a statement *false to the knowledge of the defendant* and made with the intent to deceive the plaintiff, the courts have progressed. They now hold that "fraud includes the pretence of knowledge where knowledge there is none," and where there is fraud the courts will allow protection to a limited number of persons impliedly invited to rely upon the statements of those who make them.

Auditors perhaps fear that they may be held guilty of fraud by some judge or jury if they have omitted or have done imperfectly one of the numerous things that they might do, but all of which, as a practical matter, it is impossible for them to do in any one audit. This is true, but it is no more true of auditors than of all business men, and no more true of fraud than it has always been of negligence.

If we interpret the *Ultramares* decision as the language seems to justify and if we may attempt to put it into ordinary straightforward statement, it seems that the sum of the whole matter is this: gross negligence may be regarded as evidence that fraud may have existed. That is to say, where a misstatement is due to gross negligence, intentional wrongdoing may be implied.

CRIMINAL LIABILITY OF AUDITORS

Florida seems to be one of the few states which expressly have considered the liabilities of the professional auditor in their statutory

schemes of regulation. The Florida law provides (L. 1927, Section 7875) as follows :

“ If any person acting in the capacity of an accountant shall wilfully make any false or misleading statement in writing in regard to any financial transaction or act, such person shall be deemed guilty of a misdemeanour. . . . ”

So far no case has come up in the Florida courts construing this section.

The Oklahoma statute (Okla. Stats. 1931, Section 4317) also approximates the Florida statute in that it provides “ any person holding a certificate under this act . . . who shall knowingly falsify any report or statement . . . or audit . . . shall be guilty of a felony.” No case has construed this statute.

The Texas Penal Code (Section 1133) provides that “ if any person practising in this state as a certified public accountant . . . shall wilfully falsify any report or statement . . . he shall be fined . . . ” No case has construed this statute.

CONCLUSION

It is expected that the *Ultramares* case will serve as a precedent in the United States in cases which even remotely resemble it. The decision is not in conflict with other decided cases. The judge who wrote the opinion of the court is now one of the Justices of the Supreme Court of the United States and stands exceptionally high for ability.

It may be assumed that there must be some direct relationship between the auditor and one who claims to be injured or a suit for damages cannot be maintained ; that ordinary cases of negligence will be dealt with as heretofore ; that in cases of gross negligence there will be strict inquiry into the facts to ascertain whether or not the auditor was making statements “ flimsy or recklessly given or without sincere or genuine belief ” ; and that the scope of employment should be taken into consideration in determining liability and the measure of damages.

ADDENDUM.

Since the foregoing was written the following laws affecting the profession have been enacted in the United States.

Securities Act of 1933 (Public, No. 22, 73rd Congress), approved by the President, 27th May 1933 :

Under our newly enacted Securities Act, practically all new commercial security issues must be preceded by statements which must be registered with federal authorities. Balance sheets and income accounts must be certified by an "independent public or certified accountant."

Under the Act the responsibilities and liabilities of auditors are considerably broadened and enlarged. It is too soon to comment in detail upon the pertinent provisions of the Act since much depends upon the regulations and rulings which will be forthcoming in due course and, eventually, upon the interpretation of the Act by our Courts.

In one particular the Act is quite specific and its apparent effect is to bring in the third party liability to an extreme degree. It purports to give to the individual purchaser of a security the right to sue the auditor whose certificate appeared in the registered statement or prospectus—

"In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading."

Care is taken to limit the liability to "any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report of valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him."

The liability is limited (but not much) by the following :—

"In no case shall the amount recoverable under this section

exceed the price at which the security was offered to the public." and extended (considerably) by the following :

" The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity."

Recovery of the original purchase price by the purchaser of a security is supplemented by the following :

" Any person who wilfully violates any of the provisions of this title, or the rules and regulations promulgated by the Commission under authority thereof, or any person who wilfully, in a registration statement filed under this title, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than \$5,000 or imprisoned not more than five years, or both."

Laws of Pennsylvania.

At the recent session of the Legislature of the State of Pennsylvania, the following penalty provision was enacted into law :

(Act 1463, Session of 1933, signed by the Governor on 31st May 1933) :

" Any person or persons practising as accountants, public accountants, auditors or certified public accountants in this State who shall wilfully issue or permit the issuance of any false statement of the financial transactions, standing or condition of any corporation, partnership, or individual business undertaking, shall be deemed guilty of a misdemeanour and upon conviction thereof be fined not more than two thousand dollars or imprisoned for a period of not less than ninety days nor more than one year or subjected to both said fine and imprisonment in the discretion of the Court."

DISCUSSION

THE CHAIRMAN : Ladies and gentlemen, this morning's Session is to be devoted to a subject of great importance to our profession ; and we are fortunate in the fact that those to whom the task has been given of introducing this subject are men who, by their reputation throughout the world, and experience, are most fitted to deal with it with interest and profit to our Congress.

I will now ask Mr. Henry Morgan to introduce his paper.

MR. HENRY MORGAN, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, in submitting the paper which I have had the honour of preparing for consideration by this Congress I am going to be very brief.

The high position attained by the accountancy profession and its rapid growth in this country has been due in the main to three causes : Firstly, recognition by the profession of its responsibility ; secondly, the willingness of its members to undertake responsibility ; and, thirdly, their capacity to discharge it. In fact, it would be true to say that the accountancy profession has flourished on responsibility. It would be a bad day for the accountancy profession if its members endeavoured to avoid responsibility ; but it is necessary that such responsibility as is imposed upon them should be fair and reasonable and that its extent and nature should be clearly defined.

Now, I am going to conclude my opening remarks by relating to you an incident which occurred yesterday. I had the pleasure of attending the garden party at Lord Plender's, and when I came away I found that Mr. Hill was starting to return in his car at the same moment. I saw nothing of him during the return journey ; he had gone altogether a different way ; but we were both returning to Grosvenor House. When I was near the end of my journey there was a block in the traffic, and I looked at a car alongside and there was Mr. Hill. We had gone by entirely different routes, but we had reached the same objective and at the same time. I think that that incident typifies the spirit in which members of the profession in this country regard the important subject of our discussion this morning. (Applause.)

THE CHAIRMAN : I will now call upon Dr. Voss to introduce his paper to the Congress.

DR. WILHELM VOSS, Wirtschaftsprüfer (Germany) : Mr. Chairman, my Lord President, ladies and gentlemen, I am sorry I have to begin with an excuse. I had to write on the auditor's responsibility from the Continental point of view, but when you read the paper you see that it contains particularly the German viewpoint. The reason for that is the following : When I commenced the preparation of my paper I had the intention to give you a view of the actual and the legal position of our subject in all Continental countries ; but very soon I found out that it was quite impossible to realise my intention. Firstly, because I could not get sufficient information from all those countries in the time at my disposal ; and, secondly, because I saw that the result of it would be to give you a broad picture of the whole. Consequently, I had to limit my subject to the conditions in Germany where new company law was introduced about two years ago with special provisions with regard to balance sheets and profit and loss accounts and for the compulsory audit.

I have outlined the legal position in Germany not merely because I am representing a German institute but because I feel that those provisions are so far-reaching as to be of more than passing interest to the members of this Congress.

I should like briefly to refer to the following main points : Firstly, in Germany the legal constitution of public companies and special Acts applicable to joint-stock companies differs materially from that in other countries. For example, in this country there is only one board of directors. In Germany we have the executive directors responsible for the management, and the supervisory board responsible for the supervision of the executive directors. The supervisory board is responsible also for the preparation of the annual accounts of the company ; but in addition the accounts must be examined by qualified accountants elected by the shareholders in general meeting. The auditor has to make a detailed report to the chairman of the supervisory board and he must certify the accounts before they are submitted to the general meeting of shareholders. Secondly, the auditor has to examine not only the balance sheet and profit and loss account, but also the annual report submitted by the executive board to the general meeting. This report must contain not only explanatory remarks in regard to the accounts, but also information regarding important developments and facts which are not necessarily reflected in the company's accounts. Thirdly, the auditor in Germany

is not responsible to the shareholders but to the company itself; in other words, he can be sued only by the company, not by the shareholders, except when the grounds are criminal. Fourthly, as you will have observed from my paper, the new law has indicated the lines on which balance sheets and financial statements should be drawn up. Of course it is not intended that these indications should be of a hard and fast nature. The auditor has to decide whether deviations from the legal indications are or are not justified in the interests of the company as a whole.

In conclusion, it will be observed that under the new legislation in Germany considerably more information is being furnished in the annual report and accounts, and that it is the duty and responsibility of the auditor to satisfy himself that material facts are disclosed, unless, in his opinion, the disclosure would not be in the best interests of the company, and at the same time that the non-disclosure would not be detrimental to other interests concerned. I thank you very much. (Applause.)

THE CHAIRMAN : I will now ask Colonel Montgomery to introduce his paper.

COLONEL ROBERT H. MONTGOMERY, C.P.A. (United States of America) : Mr. Chairman, my Lord President, ladies and gentlemen, I should like to subscribe to what Mr. Morgan said relating to the importance of defining our legal liability. It would be a waste of time in this audience to talk about our moral responsibility; what we should do in all cases is to point out the importance of always doing more than legally we should do. I repeat that it would be a waste of time in this audience; and, therefore, so far as I am concerned, and I think that applies to the other speakers, we are trying to determine the legal responsibility of an audit.

The paper which I originally submitted has been supplemented, and I would call your attention to the supplement, because if what is in the supplement had been known to me at the time I wrote the paper the whole paper would have been different. In other words, what seemed to be a comparatively easy task when I undertook to write the paper became one of those almost insoluble things; so I hope those of you who have had a copy of my original paper will have a copy of the supplement also, and direct your attention to the supplement even more than you do to the paper. (Applause.)

THE CHAIRMAN : I will now ask Mr. Harold Kemp to open the discussion.

MR. HAROLD F. KEMP, F.C.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, it will be agreed that Mr. Morgan has given in the comparatively short space of his paper a most lucid, informative and comprehensive statement which will constitute a very valuable addition to the many commentaries which have been delivered on this important and difficult subject. He has sketched the developments from the date of the original Companies Act in 1862 down to the present time, and has made apposite quotations from amending Acts and from judgments which have been given in our Courts on questions arising out of companies' accounts referred there for legal decision.

It may be worthy of incidental remark that when it is borne in mind that the Companies Acts have been in operation for over 70 years, and that the number of audited accounts which have been submitted to shareholders must have reached almost astronomical figures, the occasions have been comparatively few upon which it has been found necessary to take the opinion of the Courts on questions affecting the correctness of the accounts and the manner in which auditors have carried out their duties in connection with them. From one aspect this is a matter for congratulation, but at the same time it is the occasion of embarrassment inasmuch as the number of legal decisions which are available for our direction is limited as are the occasions on which judges have had an opportunity of expounding general principles for the guidance of auditors. The inference, however, is, I think, justified that the rarity of these cases is an indication that the shareholding public have, on the whole, been satisfied with the form in which balance sheets and profit and loss accounts have been rendered.

Another difficulty confronting the auditor lies in the fact that it is not easy to reconcile some of the observations of the Judges in their reviews of the cases submitted to them for decision, and as we know the legal view sometimes cuts across the almost universally accepted accountancy practice in regard to certain matters. I need only mention as a simple illustration of this point that whereas a company is under no legal obligation to make provision out of its profits for the amortisation of the cost of a leasehold property, in practice such provision would almost invariably be made.

The matter of Mr. Morgan's paper is, if I may say so, admirably marshalled. He gives us in the first part an historical résumé of the Acts of Parliament and judgments of the Courts that have a bearing on the subject,

followed in the latter part by certain constructive suggestions ; and, amongst other points, he quotes from a report of the Society of Incorporated Accountants and Auditors issued in 1932, in which recommendations for certain amendments of company law are made.

It is on these recommendations, or some of them, that I propose to make a few observations, not in any controversial spirit or as representing any but my own individual opinions, but rather with the object of stimulating discussion on this interesting and important subject.

It is well to bear in mind that the Act which now governs limited liability companies only came into operation at the end of 1929 and it was based on the report of a commission, the composition of which commanded universal satisfaction. There is much to be said in favour of the view that any amendment to this Act is premature and that fuller practical experience of its working should be gained before any attempt be made to modify it. History, moreover, teaches that no Act of Parliament, however widely drawn, can cover all possible sets of circumstances, and, further, that the ingenuity of the human mind can usually discover some means of getting round inconvenient provisions.

Two of the recommendations in the report of the Society of Accountants and Auditors referred to are to the following effect :—

“ That the profit and loss account should show the true balance of profit and loss for the period covered by such account.

“ That in the profit and loss account any debits or credits which are abnormal in character or extraneous in their nature to the ordinary transactions of the company, together with any reserve from a previous period no longer required, should be stated separately.”

Such provisions might conflict with a practice which is not unknown in many large undertakings, and while it would be conceded that they would clarify a point on which there is considerable difference of opinion, and would also relieve auditors from the necessity of forming judgments in many delicate situations, is it equally certain that such provisions would, on the whole, be to the advantage of the trading community and, in consequence, of the shareholders ? Practising accountants would probably have little difficulty in recalling from their own experience cases in which the provision made out of profits for an inner reserve has been of inestimable value as a buffer against some of the many untoward contingencies to which trading and financial businesses must be liable, and an obligation to disclose such a reserve in the accounts with an intimation of

its nature would in many instances defeat its purpose, or at least largely discount its value.

May I, by way of illustration, give a hypothetical but by no means improbable instance of what I have in mind? The directors of a manufacturing company are confronted with the early termination of a trade agreement which has for some years been in operation between themselves and their competitors, including some foreigners, and which is unlikely to be renewed, and they desire out of profits of a year to set aside a substantial sum to secret reserve to strengthen the hands of the management to meet the rate war with which they may be threatened. The disclosure of this appropriation on the face of the accounts would involve the risk of precipitating the very event which the directors, in the interests of the company, were most anxious to avoid, and yet the absence of some such secret fighting resource might well endanger the very existence of the company. Examples of the same kind could readily be multiplied. For accounts to be in such circumstances issued to shareholders without any reference to these appropriations would be wrong, but would not the reasonable requirements of the case be met by making it clear in cases where the disclosed profits of the year have been depleted by transfers to some contingency account that the balance is shown "after making provision for contingencies"? Similarly, where the profits of a year have been fortified by transfers from provisions made in earlier years and now no longer required, that the profits shown should be stated to include "transfers from provisions now no longer required."

It is not suggested that the adoption of some such phraseology would absolve the auditor from any further obligation with regard to transactions of this nature. It would still be required of him to be satisfied by inquiry that any proposed transfers between profit and loss and secret reserve accounts were reasonable in amount and that there were circumstances to justify them. These questions must be to some extent matters of degree, and each case must be dealt with on its merits, but it seems open to doubt whether the compulsory disclosure of these extraneous items would not in many instances be detrimental to the interests of the shareholders. To put the directors too much into leading strings in such a matter may be to destroy their initiative and may tend to deter men of light and leading from undertaking the duties and responsibilities of such offices if their discretion is to be so limited in what is in the main a matter of policy. Notwithstanding some notorious misdemeanours, do not the records of the past, on the whole, justify reliance on the integrity, probity,

ability and judgment of the men responsible for the direction of the company's affairs rather than on the rigid formulas of Acts of Parliament ?

Mr. Morgan speaks of an auditor reporting specifically on the profit and loss account as well as on the balance sheet. Does this mean that if the profit and loss account does not show in figures the *true* profit of the year (see page 514 of his paper) the auditor must mention the amount by which the actual earnings have been diminished or increased by any transfer ? This might prove to be a serious interference with the directors' discretion, who, after all, are the elected appointees of the shareholders to manage businesses in the best interests of the shareholders, and I might point out that directors of wide experience and sound judgment in the management of great enterprises have not, so far as I know, advocated revision of the 1929 Act in the direction urged by Mr. Morgan.

In the report of the Incorporated Society of Accountants and Auditors, it was admitted that difficulties might arise in giving effect to their suggestions in the case of banking and similar institutions, and herein seems to lie a grave objection to their adoption. It is well known that leading banks have strong internal reserve positions and it is a matter of common agreement that such positions are essential to their stability and consequently to the welfare of the commercial community whom they serve, but if it is proposed to exempt these institutions from such clauses in the Companies Acts, it might well lead to serious confusion, in view of the great difficulty of defining with precision the nature of all institutions to which the exemption should apply and the temptation that would arise to bring other enterprises within the scope of the definition. The widest powers are often given in the memorandum of a company of a commercial character and such powers have been known to include what may be regarded as banking.

It will be appreciated that these few observations are not intended as a comprehensive survey of Mr. Morgan's admirable paper, but are only designed to open a discussion in which opinions on this and other aspects of the subject will, it is hoped, be freely ventilated. (Applause.)

THE CHAIRMAN : I will now call upon Mr. Van Dien of Holland to open the discussion on Dr. Voss's paper.

MR. E. VAN DIEN (Holland) : Mr. Chairman, my Lord President, ladies and gentlemen, one may, perhaps, be allowed to ask whether it is quite correct to have papers read on "The Auditor's Responsibility from the British, the Continental and the American Points of View." It is, of course, possible to judge of this respon-

sibility in relation to the laws of various countries, but then the question is, in the first place, a legal one, even though it may be most interesting for public accountants. In this connection, however, one can only speak of a "British" point of view, as (of the three above-named countries) it is only in Great Britain that a uniform jurisdiction exists, giving final decisions binding for the whole country. The matter, however, becomes a little more complicated when one wishes to speak about an American point of view, as the various States of North America have each their own legislation, administered and interpreted by the Court of Appeal of each individual State. Nevertheless, I can quite imagine that one is inclined to speak of an American point of view, seeing that in many respects the United States form a unity. But, in my humble opinion, it is quite impossible to speak of a Continental point of view, if by continent one means the Continent of Europe. This continent at present consists of some thirty countries, each having its own legislation, its own history, its own culture, and consequently its own opinion on all kinds of questions. I can quite imagine that on some points of law Swedes and Greeks both have their own well-founded opinions and that these opinions are as far asunder as the poles. Consequently the idea that Dr. Voss gives us *the* Continental point of view will lead to misconceptions. Here one can only speak of *a* Continental point of view, and nothing else.

My opinion is that in this Congress the question should only be considered apart from any jurisdiction whatever; that is to say, from a technical point of view. Lord Plender (then Sir William Plender) defined this in his paper, "The Accountant's Certificate in Connection with the Accountant's Responsibility" (Amsterdam, 1926), as to be: "in such a manner as to indicate the fundamental principles which every accountant should bear in mind, when called upon in the exercise of his professional duties to prepare and attach his signature to a certificate." And then he rightly added that "no such (legal) limitation should be permitted to lessen the duty, prescribed by a code of professional honour, which he owes not only to his client but to the public, to the profession and to his own reputation."

Professor Limperg took up the same attitude in Amsterdam when he wrote: "I think of nothing but the responsibility from a technical and moral standpoint, apart from any civil or criminal liability, therefore also apart from any legal regulation, and so on."

If the question is considered from this point of view it matters little what legal stipulations determine the line of conduct of the accountant;

if the law should contain unlooked for stipulations in conflict with "the code of professional honour," the public accountant's choice would not be difficult. I am not going to speak on Dr. Voss's paper as mentioned in the programme, but I am speaking on the subject as a whole as I have studied the three papers together.

I make some general remarks on the subject as follows: What is now the principle which "the code of professional honour" prescribes for us? I regret to have to state that not in each of the three above-mentioned papers is to be found a clearly defined rule. Colonel Montgomery gives us in his incomparably lucid style a clear explanation of the legal responsibilities, based on legal decisions in various parts of the United States, as cited by him. I do not agree with Colonel Montgomery's opinion that it would be a waste of time to speak on other points than legal liability.

Dr. Voss restricts his treatment of the subject to his own country, in accordance with the legal stipulations which have only been in force there for a short time.

Mr. Morgan alone of the three gives, apart from the legal stipulations, an elucidation of the recommendations of the Society of Incorporated Accountants and Auditors regarding the profit and loss account, and thus shows us what, in the accountant's opinion, determines his responsibility irrespective of law and jurisdiction.

In this way we get an opinion as to the responsibility of the accountant independent of legal adjustment, consequently seen from "a technical and moral standpoint." But if we consider the recommendations carefully, it strikes us that only one of them is formulated in very general terms, and that Mr. Morgan makes various observations about the other which greatly qualify the contents.

The first recommendation (page 513) runs:—

- (a) That the profit and loss accounts should show the true balance of profit or loss for the period covered by such account.

This proposal, however well it may be meant, says little. The conditions are complied with when one side of the account contains in *one* amount the balance of a "trading account," and when this balance is called on the other side of the account, the balance of the profit and loss account.

The other recommendation is indeed worded more precisely. It runs:

- (b) That in the profit and loss account any debits or credits which are abnormal in character or extraneous in their nature to the ordinary transactions of the company, together with any reserves

from a previous period no longer required, should be stated separately.

It is, however, striking that he immediately continues: "I ought to add, however, that some directors and others responsible for the management of public companies would assert that compulsion to adhere to this principle in all circumstances would not be in the best interests of shareholders."

And here we come to one of the causes of the problem, to which attention may be drawn separately. Reference is repeatedly made to the interests of the shareholders and to the necessity of giving them full information. And even in the address to the jury in the *Royal Mail* trial, Mr. Justice Wright asks: "If shareholders do not know, and cannot know, what the position is, how can they form any view about it at all?"

The question for me is always whether it is so necessary to let the shareholder know the ins and outs of everything. The position of shareholders with respect to joint-stock companies is quite different from that of partners with respect to a firm. At any moment shareholders can liquidate their interests in a company, and do so as soon as they see any advantage in it. Information given to the shareholder is often nothing else than information given to the speculator, whose one wish is to make as much money as possible out of the company and then to transfer his interests to others. In many cases the shareholder is the company's worst enemy; and it seems to me that the private interests of the shareholder are often in conflict with the actual interests of the joint-stock company. In my opinion, the interests of the individual shareholder may not be taken as directive in formulating the responsibility of the auditor.

Consequently, I certainly do not endorse the opinion of Dr. Voss that "we are responsible not only to the company but also to its executives, to the shareholders, to creditors and to the public"; it seems to me that this opinion is not serviceable as a scientific formula for the responsibility of the accountant.

The more one considers the problem, the more it proves to be impossible to define this responsibility otherwise than in a very general sense. Colonel Montgomery states the situation correctly when he says that "the service of the auditor chiefly consists of rendering an opinion," and I am in perfect agreement with him when he says that "where there is negligence there is liability." But he rightly postulates at the same time that, "What may be held to be negligence in one case may be excusable

in another." This description, in conjunction with that given by Lord Plender in Amsterdam, is, in my opinion, the only directive for the determination of the accountant's responsibility.

However, I can quite imagine that many consider this formula too vague to serve as a directive in case the material responsibility of the accountant has to be determined by the Judge. Therefore, I may point to Dutch legislature which, although couched in very general terms, also contains sufficient stipulations for the material responsibility of the accountant.

By Articles 1401, 1402 and 1403 of our Civil Code, which articles are taken practically in their entirety from the French Code Civil, the following stipulations are made :

1401 : Every unlawful deed, by which damage is caused to another, places the person through whose fault this damage has been caused under the obligation of indemnifying same.

1402 : Everyone is responsible, not alone for the damage caused by his own deed, but also for that which he has caused by his negligence or carelessness.

1403 : One is not alone responsible for the damage caused by one's own deed, but also for that which has been caused by the deeds of persons for whom one is responsible, or by transactions under his supervision. Parents and guardians are responsible for the damage caused by minors domiciled with them and to whom they act in *loco parentis*.

Masters and those who appoint others to act for them are responsible for the damage caused by their servants or subordinates in the performance of activities for which they have employed them.

Schoolmasters and foremen are responsible for the damage caused by their pupils or by their men during the time that they are under their supervision.

The responsibility mentioned above ceases if the parents, guardians, schoolmasters and foremen prove that they could not have prevented the deed for which they would have been responsible.

A logically consistent application of these stipulations is, in my opinion, sufficient for all countries to punish those who, through negligence, fall short in their duties as auditors. And Article 1403 even holds them responsible for the negligence of their subordinates.

It goes without saying that not only negligence, but also design, falls within the meaning of these stipulations.

And it is not necessary to tell this meeting that expulsion from the profession is a severer punishment than any legal punishment whatever for him who intentionally neglects his duty. (Applause.)

THE CHAIRMAN : I will now ask Mr. Parton to open the discussion on Colonel Montgomery's paper.

MR. J. PARTON, F.C.A. (Canada) : Mr. Chairman, my Lord President, ladies and gentlemen, in reading Colonel Montgomery's paper I have taken the view that we are getting information from the various parts of the world on the principles and the practices of those parts. Secondly, in opening the discussion on Colonel Montgomery's paper, I have treated it rather as an informative paper than a discursive one ; and since he is speaking from the American point of view and I come from Canada I think you will find I have not gone very far into preaching sermons (shall I say ?) ; I have tried to give you some real information regarding Canada.

The first point that strikes one in Colonel Montgomery's address is that there appears to have been very little in the way of statutory enactment in the United States regarding audits or auditors' reports. That comment was written before I saw Colonel Montgomery's supplement, but I do not think it makes very much difference with regard to my remarks. This is very different apparently from the position either on the Continent of Europe, the British Isles, or in Canada.

I believe that in Canada we have as much in the way of statutory enactment in this regard, if not more, than any other country. Unfortunately, people in Canada have yet to learn a good deal regarding the scope of audits and auditors' responsibilities. I think it is the common experience of all Canadian practitioners to find clients expecting the auditor to assume considerably more duties and responsibilities than would ordinarily be expected in countries where the profession had been more definitely and firmly established, at any rate, than it is in Western Canada. Such additional duties which seem to be expected, and which are usually resisted by the auditor, have at times gone into the realm purely of management, which calls to my mind a colleague of mine making the statement once that a certain client seemed "to expect us to carry out managerial duties for an office boy's salary." (Laughter.)

I should like to interpolate a word that in making these comments I am not unmindful of the remarks in Professor Annan's address, nor the further comments which have been made this morning.

Another difficulty with which we in Canada are confronted is the unfamiliarity on the part of some of our judges regarding auditors' work. Colonel Montgomery states (p. 545): "If the proximate cause of the loss was the negligence of the client's own officers or employees, the auditor should be freed from liability, following the accepted principles of the law." In a recent case heard in Winnipeg, in which the judgment in the first instance was against the auditors, the judge gave his judicial pronouncement that "when the defendants assumed their duties, and continued to carry them out from year to year, the necessity for special vigilance by the plaintiff as against its employees was removed." In this particular case, senior officials of the company involved had admitted in evidence that they had signed cheques and passed numerous transactions without any inquiry. I am very glad to say, however, that since landing in England, I have heard that this judgment has been reversed on appeal.

The subject under discussion is narrowed to the matter of balance sheets and profit and loss accounts. I have done some searching and have made a number of inquiries, but, while there have been a number of cases in Canada, as far as I can gather all these have been connected with the matter of the non-detection of frauds and defalcations, and have had no connection, except indirectly, with responsibility for financial statements. We therefore have to rely largely on British cases, although American cases are sometimes cited and possibly would have some weight in our Courts.

Canada has nine provinces, each of which has its own Companies Act, in addition to a Dominion Companies Act. All these Acts differ in many materials. Most of them, however, require balance sheets to be drawn up in a certain manner, and to disclose certain specified things. The requirements for auditors' reports to shareholders under the Dominion Companies Act are exactly the same as those in the British 1907 Act, quoted in Mr. Morgan's paper on page 495. The Manitoba Companies Act has two clauses in similar terms, with a further clause in which the auditor is expected to say "whether all the transactions of the company that have come within his notice have been within the objects and power of the company, to the best of his information and belief." I believe the other provinces have similar clauses in the case of ordinary companies.

These latter clauses gave those of us who were in Manitoba some little trouble, because originally it did not include the rider "to the best of his information and belief," which I have mentioned above, and counsel's

opinion was that the auditor must report in the words of the Act, making a definite statement that transactions were or were not within the power of the company, and not just expressing an opinion. Representations were made to the Government of the province, which finally resulted in this qualifying clause being added. It had to be pointed out, of course, that Chartered Accountants were not, and did not profess to be, lawyers, and that it might frequently happen that transactions may take place which would require not only a legal opinion to decide, but possibly even a judicial pronouncement.

The Canadian Bank Act has a somewhat similar requirement, and various provinces have also enacted legislation of a similar nature regarding trust and loan corporations. Ontario goes perhaps further than any other Canadian Government in issuing, under powers conferred by the Act, a "Memorandum of Rules for minimum auditing requirements of loan and trust corporations registered in Ontario." This memorandum is, to all intents and purposes, the audit programme. Under the same Act, the auditor is required to make the statement that, "after due consideration, he has formed an independent opinion as to the position of the corporation; that, with his independent opinion so formed and according to the best of his information and explanations given to him, he certifies that, in his opinion, the statement sets forth fairly and truly the state of the affairs of the corporation; that all transactions of the corporation that have come within his notice have been within the powers of the corporation."

Many opinions have been expressed by various practitioners on the meaning to be attached to this phrasing, and the responsibilities in which the auditor is involved. Personally, I am of the opinion that it really means no more than is indicated by the report on companies in general quoted above, and which, as I have stated, was copied by Canada from the British 1907 Companies Act. If it means anything at all to me, it is simply that our Legislatures are trying to emphasise what are already decidedly the auditor's responsibilities. With the older form of report, the auditor merely says "In my opinion." The newer phrasing is simply emphasising the fact that, if an auditor gives an opinion, it is to be his own independent opinion, and not anyone else's; and I do not think this is really any different from the older expression.

Another requirement under the Loan and Trust Corporations Act is that certain returns are to be made to the Government. Such returns include, *inter alia*, an affidavit, made by the auditor, again giving all the

particulars as mentioned above, but with a further statement that he is performing the duties set out in the memorandum of rules for minimum auditing requirements as hereinbefore mentioned, or, if not, also stating in what particulars he has made any omissions. This probably does make a real addition to our responsibilities, yet not a very great one, as these Government requirements are not onerous, and some of us think they do not go far enough. So far as I can gather, most of us carry out more than is specified in these minimum requirements.

A recent further responsibility which has been laid on auditors in Canada comes under various Provincial Acts known as "Security Frauds Prevention Acts." These enactments arose from a number of prosecutions of people who were operating stock brokerage offices some few years ago in which considerable amounts were frequently lost by investors, and the provisions of this Act require all stock exchanges to make rules for the audits of the accounts of their members. The different provinces have some different requirements, but I think they all are intended to determine whether or not a broker is solvent, and in a position to meet his engagements. The one I know most about myself is the Montreal Stock Exchange, which does not require figures from the auditor or from the broker, but does require a statement from the auditor that the broker is or is not solvent, the auditor being instructed as to the manner in which he should make up the computations for the purpose of determining whether the broker is solvent or not, according to the definition given to the word by the Stock Exchange Committee. It might be of interest for you to know that one requirement is that the broker is not allowed to place any value on his seat on the Stock Exchange in making up the statement of solvency.

Colonel Montgomery speaks of the "Balance Sheet Audit." We have generally come to the conclusion in Canada that there is no such thing as a "balance sheet audit" contemplated by our statutes. It does not, by any means, follow that a detailed audit is necessary in every case, nor that the auditor must ignore any internal audits and internal checks which are being performed. We believe we have the right to take cognisance of any means instituted by a client to prevent or detect petty frauds and errors, and, if in our judgment there is an efficient system in this regard, that we can modify our work accordingly. The question as to whether specific arrangements can be made with clients regarding the amount of work to be done is still *sub judice*, although at the moment the case I have in mind has gone in the auditor's favour.

I have felt that the best way to open this discussion is to state a series of facts on Canadian requirements, since the United States is so close a neighbour, and I hope these will be found informative, and assist in the further discussion which is to follow. I would also like to say that I have endeavoured to avoid long citations or matters which might have tended to lengthen my remarks unduly. I have, however, various copies of statutes and other matters mentioned, and should be very glad to show them to and discuss them with any of you who may be interested. Those papers are not in this room. If you want to see them you can see them afterwards.

To prevent any misunderstanding of the general tenor of my remarks, perhaps it will be as well for me to say, in conclusion, that Canadian accountants do not take a narrow view of their duties by sticking to the letter, "which killeth," but they do try to act "with the spirit, which giveth life." In more modern terms, we do not act on the mere phraseology of our statutes, but do our utmost to carry out all that that phraseology implies. (Applause.)

THE CHAIRMAN: There are many this morning who have expressed their willingness to take part in this discussion, but none whose views we shall not wish to hear. I am afraid I must ask those who speak to be brief in their remarks. Mr. Van Dien has made a suggestion. He has suggested that it might be useful if the red light were coupled to an explosive bomb. (Laughter.) I will not tell you whether his suggestion has been adopted.

I will now call upon Mr. Furnival Jones to address you.

MR. E. FURNIVAL JONES, F.C.A. (Great Britain): Mr. Chairman, ladies and gentlemen, I must ask you to excuse any shortcomings in what I have to say, owing to the nervous disturbance from which I have suffered since I saw the notice about the red light as I came into the room, and the uncertainty as to what is to happen if one ignores the last one. (Laughter.) It has upset my nerves to the extent that I have a feeling that I am rather entering into a relay race, and I expect the chairman to start me off with a pistol, and the last speaker to hand me a stick.

The time being so limited, and the principal thing which I wish to say being to thank those gentlemen who have written these admirable papers for our discussion to-day, and to congratulate them upon their efforts, I thought it would probably save time if I omitted my speech and said it with flowers and just handed them an appropriate bouquet of white lilies, indicating the blameless character of the accountant's profession.

(Laughter.) I think we all owe a very great debt of thanks to them, because I believe, as Colonel Montgomery suggested, it requires a certain amount of courage for a professional man to discuss his responsibilities in public. One of the wise sayings which have guided my life, the author of which the Chairman will remember, is this: "Never try to practise what you preach." (Laughter.) You will probably only succeed in bringing your principles into contempt. That, of course, is not intended as a sneer against high principles, but as a warning against the bad habit of preaching. (Laughter.) The danger to the professional accountant who preaches regarding his responsibility is that he may be expected to practise what he preaches. If he sets his principles too high he may fail to live up to them. If he sets them too low, the public may well ask: What is the use of an auditor? We can avoid this by sticking to generalities; but all our speakers who have written papers for us this morning have had the courage to deal with particular circumstances and particular facts. I am naturally most interested, practically interested, in the English and the British point of view, and I have read Mr. Morgan's paper with greater care than the others. I should like to congratulate him particularly on the excellent historical survey of the responsibility of auditors as expressed in our legislation and in the decisions of Judges. I should also like to say that I believe the ideals which he expressed will meet with general assent from all. I am only, like Mr. Kemp, a little bit hesitating and diffident when it comes to practical suggestions as to further legislation. As I gather from Mr. Morgan's paper, running through it is a suggestion that in the past auditors have taken rather too narrow a view of some of their statutory duties. I am afraid that a narrow view—I am speaking with great modesty; I am putting my opinion forward—will always be taken of statutory requirements. When any definite duty is put into an Act of Parliament it tends to become the maximum and not the minimum duty.

Towards the end of his paper, Mr. Morgan uses a phrase which was used long ago by a Judge, I think, of calling the auditor the watch-dog, which reminded me of the remark of the gentleman whose name I have not, I think, permission to mention, but who is well known to many of you, who when that phrase was used some years ago, said: "Yes, we are described as watch-dogs. I sometimes think we are like my little dog which only barks when the bell rings." (Laughter.) There is a danger that if you put too many bells into an Act of Parliament, the barking will be confined to the occasions when the bell rings, and I think it is not quite the British point of view, the British method, to rush very readily into legislation.

My reading of history of British law in all things is that it has followed a good way behind public opinion and public practice as interpreted by Judges. Probably some of our visitors from abroad could tell us of the dangers of legislating in advance of public opinion. We do not want to do that. And a good illustration of this method can, I think, be found in the history of legislation as regards auditors, which we find in Mr. Morgan's paper. For forty years or so there was no statutory duty to have an auditor at all, but most companies had auditors. Even in the present Companies Act there is no definition as to what an "auditor" shall be—what his qualifications shall be. I imagine it would satisfy the Act if we had a tinker, a sailor, a soldier, a baker, a beggarman, or even a thief, as auditor; but the directors who have the nomination of auditors have always appointed expert accountants, the very class who are most qualified to catch them out if they do anything wrong. The same as regards the duties of auditors; they are very vaguely defined. Even the one duty which is fairly defined in what they shall report about the balance sheet is full of qualifications; it simply says, as you will remember, that we report according to the best of our information, according to the books of the company, according to the explanations given us, without taking the trouble to provide beforehand that the person appointed must be one who is competent to make a selection of the information given to him, to understand the validity of the explanations given to him, or even to understand the books of the company.

Now, I gather from Dr. Voss's paper that German legislation is providing for most of these things, and definitely it says what shall be the qualifications of an auditor. It says to him that he shall report; it says how the accounts shall be prepared. I should very much like to wait and see what is the practical effect of that legislation in Germany, even allowing for the different conditions there, before we start on any legislation here; and if we do I think it will be well to go further back and begin to say what a Chartered or Incorporated Accountant shall be, just as we do in certain special Acts now, and to cover a much wider field than is covered by these proposals, which have been approved, excellent though they may be, in principle. We must also, I think, try and educate public opinion as to what a shareholder has a right to receive. I was delighted with Mr. Van Dine's remarks on that subject. Shareholders must not expect too much; they cannot get it. I think that at every shareholders' meeting, at the back of the platform should be Tennyson's words: "We have but faith, we cannot know." (Laughter.)

If any of us were asked to advise a person whether to buy a business, I do not think any of us would say we had got sufficient information to advise him from any printed balance sheet that we have seen. We should want to know a very great deal more than that ; and yet the Stock Exchange and other people who fix prices—I do not pretend to understand the methods they adopt—advise their clients to buy and sell shares on information which would be insufficient to enable us to advise our clients about buying a business. That is inherent in the nature of companies ; it cannot be done ; they must have faith ; and I do not think that it does any good to pretend that it is ever possible to publish any statement of manageable proportions on information which is going to give a shareholder anything like the knowledge to enable him to exercise an effective control over the business. It would be better, I think, to agitate that private individuals should be prevented from holding ordinary shares at all. (Laughter.) They should buy them through organisations that are able to exercise control. I think that is a point that is well worth considering, and the whole limits of the possibility of information to be given in balance sheets is one to which we might well devote some time in discussion.

I had a great deal more to say, as most of us could have done, on this subject, but I have overlooked the red light and I am not sure how long it has been going, so I shall retire before the explosion. (Loud applause.)

THE CHAIRMAN : I will call upon Mr. Hinnen, of Holland, to address the Congress.

MR. G. K. H. HINNEN (Holland) : Mr. Chairman, my Lord President, ladies and gentlemen, with great interest I have read the papers concerning this subject.

When I received the programme of this Congress I saw that Mr. Morgan would treat the British, Colonel Montgomery the American, and Dr. Voss the continental point of view. As a Dutchman I belong to the Continent of Europe, and therefore I was especially interested to learn from Dr. Voss the continental point of view.

But I must say that I was somewhat disappointed when I received his paper. He deals only with conditions in Germany, while he says that his remarks are substantially equally applicable to the remaining continental countries. I doubt whether this is right in all respects. I cannot speak for the other continental countries, but the ideas in my country are not quite the same as those of Dr. Voss.

He says : “ The work of the auditor ends with the issue of the certificate

and with the report to the supervisory board." In my country there are many accountants who are of opinion that an auditor is also responsible for the financial communications in an annual report, which also contains the balance sheet and the profit and loss account of which he approved.

In his book "Handbuch für das Revisions-und Treuhandwesen," Dr. Voss considers the test-checking procedure permissible. In my country we do not think it permissible for the approval of the annual accounts. This does not mean that every entry in the books should be verified ; in many cases also with the aid of so-called audits of totals a substantially complete verification can be obtained.

At the end of his paper Dr. Voss says that our profession must carry out its tasks to the benefit of the State. I am anxious to hear how it should be done. I think this claim should be put down to the present political situation in his country. In my opinion, the benefit of a State is best served by a sound business life.

Now, coming to Mr. Morgan's paper, I must say that I fully agree with his pleading against secret reserves. Also, in my opinion, a balance sheet that contains secret reserves does not show a true and correct view of the state of the company's affairs.

Further I agree with Mr. Morgan that the auditor's responsibility for the profit and loss account should be placed beyond question. In my country the leading societies of accountants have enacted in their "Regulations for the Performance of the Audit" that the signature of a balance sheet by a member means the approving of the balance sheet and the item brought in from the profit and loss account. Though mention is not made expressly of approving the profit and loss account, it is beyond question that this is implied.

My Society, the Nederlandsche Bond van Accountants, has further enacted that if a member does not sign a balance sheet, but reports upon this balance sheet, it is assumed that he approves of the balance sheet unless he makes a statement to the contrary.

I will end by expressing my thanks to the writers of the papers for the clearness with which they have explained the situation in their respective countries. (Applause.)

THE CHAIRMAN : I will now ask Dr. Drăgănescu Brates, of Roumania, to address the Congress.

DR. P. DRĂGĂNESCU BRATES (Roumania) : Mr. Chairman, my Lord President, ladies and gentlemen, I take the liberty of making a few remarks on Dr. Voss's paper regarding the auditor's responsibility (I should say

the responsibility of accountants and auditors) in relation to balance sheets from the continental point of view.

Dr. Voss has agreed he has not treated the subject from the continental point of view because he had not sufficient information (that is according to Einstein's formula) regarding the principles of our responsibility, and in a quotation of Professor Limperg, Holland, Dr. Voss limited his viewpoint and dealt in a more detailed manner with the conditions in Germany. But as Dr. Voss recognises that each country has its own system of law for dealing with these matters, I think he could have made a brief comparative research in regard to the basic conditions in France, Italy, Switzerland, Roumania, Austria, and some other European countries at least.

And, furthermore, as Dr. Voss emphasises the responsibility for the normal audit of the annual accounts, he should not have regarded the auditor only as an auxiliary of the supervisory board, but as a *member* of that board.

And this is a point upon which I should like to insist. In most countries on the Continent the members of the supervisory board—*comité des commissaires*—*aufcomptes aufsichtsrat*—censors they are called in our country—are lawyers, engineers, physicians, clericals, &c., men who have not a proper training for performing their tasks, who have no responsibility towards the body of specialists, who have no real sense of responsibility in so far as they accept a reward for a duty which they are not capable of fulfilling. We succeeded in Roumania in passing a law requiring that one of the censors of limited companies created after the law had passed through Parliament (July 1921), and having at least 5 millions as capital, should be an accountant; but the other censors are all sorts of men.

I think that this is an anomaly which should come to an end. We have to ask—as far as the Continent is concerned—that not only our responsibilities should be defined, but that none should be allowed to certify a balance sheet as correct unless he is qualified to do so. We shall ask penalties from those who would assume a task for which they are aware they cannot be made responsible, just as we should have to pay a penalty if we signed a medical certificate, or a blood test certificate.

And, in conclusion, I would say that I quite agree with the author when he says that "audit is often regarded by the public as a mere formality, while it has a considerable importance." But that is also due to the small amount of interest our profession has stimulated in the

public mind. We should make people understand our motto: No rights without corresponding duties and responsibilities. (Applause.)

THE CHAIRMAN: I now call upon Mr. Fukátko to address the Congress.

MR. ING. JAR. FUKÁTKO (Czechoslovakia): Mr. Chairman, my Lord President, ladies and gentlemen, the speakers before me have very comprehensively discussed the subject on hand from the point of view of the legal regulations of their respective countries.

Allow me to add a few observations as to the question of the auditors' responsibility in Czechoslovakia as well as in the other countries of Central Europe, by which I mean Austria, Hungary, Poland and Yugoslavia, the legal regulations of these countries being approximately of the same structure.

Up to the present compulsory auditing of balance sheets of the different companies by expert auditors has not been ordered, although the societies of expert auditors have long been trying to bring about its introduction.

According to the present legal status audits in public and private limited companies are being performed by elected supervisory boards—usually consisting of three members—as a part of their supervising duties, or by at least two inspectors of accounts.

A member of supervisory boards or an Inspector of Accounts may be any person who is in possession of all rights and has been elected for the exercise of the supervising functions by the general meeting. Unfortunately, unlike in Great Britain, it has not become customary in practice to appoint as members of the supervisory boards professional auditors or expert accountants—the result being that their influence in this field of audits is still rather small and it is owing to this circumstance that the institution of supervisory boards in our public and private limited companies often fails.

Under the present law the supervisory organs have the duty to examine the balance sheet and the profit and loss account and the appropriation account. A report on the results of their examination must be presented to the general meeting every year. It has become customary for the supervisory organs to submit to the general meeting a detailed audit report together with the proposal to grant or refuse discharge from responsibility to the Board of Managers. Moreover, they attach at the foot of the balance sheet a special certificate in which they summarise their total audit judgment.

In the wording of the certificate we find both the audit judgment which certifies the correctness of the balance sheet as to figures as well

as contents, and a confirmation certifying only the numeric accordance of the balance sheet with the books. The responsibility arising for the supervisory organs is two-fold ; under civil law and under criminal law. The extent of both responsibilities is laid down by the regulations ordering that the supervising activity must be exercised with reasonable carefulness of a good business man.

Under civil law the supervisory organs are responsible for any damage caused to the company by gross negligence on their part. They can be prosecuted under criminal law if they have committed a fraudulent action in their audit report or certificate. Fuller regulations as to the contents of the audit report and responsibilities of auditors exist in case of private limited companies whose audits are performed by expert auditors on the proposal of the minority of shareholders at the general meeting. In such cases the expert auditors are obliged to work out a report in which must be stated : (1) whether they have obtained all information and all explanations they have asked for ; (2) whether the balance sheet exhibits a true and correct view of the financial position of the company. The contents of the certificate which the expert auditors give in this case is similar to the wording of the certificate in use in Great Britain.

In addition to compulsory audit by statutory organs of public and private limited companies, there exist in Czechoslovakia the so-called compulsory autonomous audits of co-operative societies undertaken either by auditor associations, unions, through their own expert auditors or by auditors appointed by Courts of Justice or by the Provincial Government. A special law has laid down the rules to govern the auditors in the exercise of their duties. They have also the duty to examine the balance sheet and the profit and loss account. They are obliged to give a written report about the results as to both the material and the formal correctness.

The responsibility of co-operative auditors is regulated by Common Law and its extent is the same as in the case of supervisory organs in public and private limited companies. If we appreciate the extent and contents of balance sheet audits and the responsibility of auditors in our country we must say that there prevails a lack of unity and clearness. The main causes responsible for this unsatisfactory state are to be found in the following circumstances : (1) The too general character of the legal regulations as to the contents of the audits of the balance sheets of public and private companies ; (2) The absence of legal regulations

as to the expert qualification of companies' auditors, resulting in the auditing function being frequently entrusted to persons who lack the necessary qualities for the exercise of their function and thus have no realisation of their responsibility. Our auditor associations are trying to bring about improvements in this respect. The main principles that we lay down are as follows : (1) The auditor should not by the contents of his certificate arouse greater confidence than is justified by the extent, contents and progress of his auditing work ; (2) A satisfactory certificate can be based exclusively on a thorough and material audit of all accounts and not only on the numeric accordance of the balance sheet and of the profit and loss account with the books ; (3) The limits of an auditor's responsibility are given by the purpose of the audit and of the certificate, by his professional care that can be expected solely from a qualified auditor, and, lastly, by his subjective judgment ; (4) Further, we recommend that the certificate should contain references to the detailed report as far as given by the auditors. (Applause.)

THE CHAIRMAN : I now call upon Mr. Wardhaugh to address you.

MR. JOHN B. WARDHAUGH, C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, I am glad that the title of the papers so admirably submitted permits of the treatment of the subject from a broad point of view and not merely from the point of view of the simple limits of an auditor's responsibility.

In my view, it is at least open to question whether a restatement of our duties and obligations in more detailed form in a new Companies Act would be advantageous either to the shareholder or auditor. What, in my opinion, is wanted is a disposition on the part of auditors to take a broad view of their responsibilities. For example, although they may have no power to compel a company to adopt a particular form of accounts, they should exert their influence with directors to ensure that the published accounts are so framed as to be not merely " within the law " but reasonably informative to the shareholders. This particularly applies to the profit and loss account, and where this account is appended to the balance sheet reported on by the auditor there seems to be no doubt that he is responsible for its form and content.

It may be felt that our position would be easier if there was a statutory definition of a profit and loss account and what it should contain, but one has only to try and frame such a definition to realise how difficult the task of definition is, and he does not go far before he is met in one form or another with the anomaly of a so-called " true " profit and loss account

co-existent with what are in essence inner or secret reserves. On these questions it will be difficult to obtain statutory enactment, but I would suggest in passing that our hands would be greatly strengthened if the Stock Exchange could be prevailed upon to make it a condition of quotation that certain specified information be given in the published accounts. Even a clear indication of their views and of the consequences of failure to comply with them would have a salutary effect.

A step in this direction has recently been taken by the New York Stock Exchange in announcing that the stocks of a certain company would be stricken from the Stock Exchange list on a specified date unless prior thereto the company furnished stockholders with adequate information regarding the company's affairs and agreed with the Exchange as to the manner in which the financial reports of the company would be published in the future.

In the meantime, what attitude is to be observed regarding the controversial subject of inner reserves? Whatever may be the opinion as to the disclosure of the creation of such, it appears clear that where the profit and loss results of a year have been appreciably affected, (a) by the utilisation or bringing to credit of any reserve fund (whether such reserve fund has previously been disclosed or not), or (b) by bringing to credit any excess of a provision previously made for an estimated liability over what is found to be the actual requirement, we must see that the amount of such reserve fund or excess provision brought to credit is disclosed in the profit and loss account or that at least a note stating that such a credit has been made before arriving at the figure of profit and loss shown in the account.

Again, a company may not be bound at law to write down its fixed assets and it may be sufficient to indicate that they are stated "at cost," but the auditor should exercise a careful and independent judgment as to the valuation; and, where necessary in the interests of the shareholders, he should express to them his opinion. Where he has strong grounds for doubt as to the sufficiency of a provision made, but is unable to express a definite opinion, it may be advisable for him to state that fact.

Where the auditor is unable to satisfy himself independently as to the correctness of the valuation of stock in trade and work in progress it may be desirable in certain cases that he should indicate in his report the extent to which he has accepted the inventory and valuation upon the certificate of the company's officers.

Where it is anticipated that a loss will be sustained on the completion

of current contracts for the purchase or the sale of raw materials or other stock, or on the completion of work in progress, suitable provision against such loss should be made. Where provision is not made the matter may call for reference in the auditors' report.

It frequently happens that commitments have been made for the acquisition of fixed assets which not being yet due, at least in entirety, do not automatically register in the balance sheet. The auditor should see that the extent of such commitments is clearly indicated.

Where litigation is pending careful consideration should be given to the probable financial effect thereof on the company and the advisability, always keeping in view the interests of the company as litigant, that some reference to such liability should be made in the accounts or in the auditors' report. (Applause.)

THE CHAIRMAN : I will now ask Mr. Thomas Keens to address you.

MR. THOMAS KEENS, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, from the general discussions which have taken place this morning it seems to me that we have to come to consider broadly the question as to whether any amending legislation of the Companies Act in this country is required, or whether it is not altogether premature. I have not heard in the discussions this morning any very severe criticism of Mr. Morgan's paper, or of the general conclusions to which he comes. But it all comes back to this, as to whether or not, having regard of course entirely to the Companies Act in this country, that so soon after an Act of Parliament which only came into operation in 1929 any further amending legislation is required.

I am very much indebted to Mr. Kemp for that very fine paper which he has given us in opening this discussion, and I am also extremely thankful to Mr. Furnival Jones for introducing a little touch of humour into proceedings in which it is extremely difficult to get any. I was also delighted when he dropped into poetry although I had a horrible feeling that he was going to quote instead of Tennyson the words, "All hope abandon ye who enter here." At any rate, we were spared that.

But let us just look at this one important question, and I think that is all I can profitably add to the discussion this morning. We all know that it is the practice of the Government of this country in promoting legislation dealing with companies first of all to appoint a Departmental Committee, and then, generally speaking, the legislation which is introduced is based upon the report of that committee and follows very directly upon it. Those of us who had anything to do with the Companies Bill

prior to it being an Act know very well that the only possibility of getting even the smallest amendment introduced was by way of consultation with the President of the Board of Trade before the Bill was introduced. Once having been introduced, the Government stick to the report and go through with it.

No one denies for a moment that the Committee which was appointed prior to the Bill which ended in the Act of 1929 was a very strong committee—an extremely strong committee. The accountancy profession was very well represented on it. They did their work admirably ; but in the view of those of us who formed the special committee appointed by the Society of Incorporated Accountants—we were appointed especially to consider the Act of 1929 in the light of subsequent happenings ; and we came to the conclusion—we were forced to the conclusion—that if that committee had had in front of it when it was sitting the information which is now at the disposal of all of us it is more than probable that their recommendations would have been different in character ; and that is what we believe will be the case now. We also say this, that it is utterly impossible in the present state of the profession in this country, in spite of everything that we believe, of the standing of our colleagues and the independence which they manifest, but it is absolutely impossible for the smaller man in this country who is not in the position of unquestioned superiority and eminence occupied by the large firms to take that view of extreme independence which the situation requires unless he is backed up by Act of Parliament—(applause)—and we therefore suggest that it is not premature that the Government should be asked to appoint another committee in the light of recent happenings, and that among the things which they should deal with should be the problems which are dealt with in this report. In addition to this, I would suggest off my own bat that there should be steps taken so to protect the position of the auditor that even if he be the smallest man who has to think of his bread and butter he should be able to stand up and occupy the position of independence which he ought to stand up and do. (Applause.) No one would desire to shirk responsibility, but we do ask that in assuming those responsibilities, in carrying out our duties to the public, we should have the protection and support of an Act of Parliament. In my view, amending legislation is now required and should be proceeded with. (Applause.)

THE CHAIRMAN : I will now call upon Mr. Charles Reid to address the Congress.

MR. CHARLES REID, D.S.O., M.A., C.A. (Great Britain) : Mr. Chairman,

my Lord President, ladies and gentlemen, I would like to congratulate Mr. Morgan on the clear and fair manner in which he sets forth the position of auditors in this country. I do not, however, agree with all Mr. Morgan's conclusions.

In the first place, Mr. Morgan describes with great care a recent case—the *Royal Mail Steam Packet* case—and he proceeds to draw conclusions from that case. In my opinion, there are no new conclusions affecting auditors to be deduced from that case for the following reasons :—

- (1) Because the accounts in question were issued prior to the 1929 Companies Act, which, as Mr. Morgan admits, contains important provisions as to the contents of balance sheets and the auditor's responsibility.
- (2) Because auditors are, and in my opinion always have been, definitely responsible that the figure which is stated as the profit or loss for a period is as true and correct a figure as is possible to ascertain in the circumstances of each case.

If the balance sheet is correctly stated it follows that the profit and loss balance is also correctly stated.

- (3) As regards secret reserves, I feel sure that the majority of our profession agree with Lord Plender's statement which is set out fully on page 503 of Mr. Morgan's paper.

I can see no breach of accountancy principles, or of the auditor's duty in regard to the non-disclosure of such reserves except in cases of abuse. There is just one question I would like to ask the writer of the paper—whether he would regard as untrue balance sheets and profit and loss accounts which do not take into account the unrealised appreciation in fixed asset values, and the difference between the cost price of current assets and their equivalent cash realisation values.

The public have two safeguards :—

- (1) Section 124 of the Companies Act, which prescribes the manner in which facts are to be disclosed in a balance sheet ;
- (2) As I have said before, the auditors are responsible that the figure which is stated as the profit or loss for a period is as true and correct a figure as is possible to ascertain in the circumstances of each case.

This would preclude the utilisation of reserves in any manner which might be misleading.

After all, a balance sheet is a picture of the position of a company at a

stated moment as a going concern, and not a mathematical tabulation of figures representing certainties.

The main point in this paper on which I disagree with Mr. Morgan is his proposal that further responsibility should be placed on auditors by means of legislation.

Is not he confusing two distinct issues :

(1) The amount and nature of information given in the published accounts of companies ?

(2) The position of the auditor in relation thereto ?

With regard to the former, in reference to holding companies and subsidiary companies, I would like to endorse the conclusion of Sir Albert Wyon in his paper dealing with that subject : " The solution of the problem is not to be found in legislation, though laws more helpful than those now in force in this country could doubtless be devised, but laws cannot usefully set a standard of conduct such as directors and auditors truly concerned for the welfare of shareholders would wish to adopt, but only a minimum standard to which even the least conscientious must adhere or be subject to penalties. Neither directors nor auditors should be satisfied with bare compliance with such statutes, nor should the accountant be content merely to adopt and follow public opinion ; in a field in which his experience gives him special competence he should aim to lead public opinion in the right direction. To achieve our full measure of usefulness we must combine honesty, independence and care in discharging our responsibilities with a broad view of the limits of those responsibilities and a willingness to extend those limits to meet the changing needs of business and of the investing public."

Now take the position of the auditors in relation to the published accounts. Our textbooks give as the chief object of an audit : (1) the detection of fraud ; (2) the detection of errors ; but, in my opinion, the main object of an audit, in particular that of a public company, is to have an independent opinion as to the manner in which the accounts are stated, i.e. to see that capital and income are properly distinguished ; in other words, that the accounts are drawn up on sound principles.

Incidentally, audit fees are obviously based on the principle that the duties of auditors are limited to the primary object.

Under the present Companies Acts, the auditor's responsibilities are quite wide enough. These Acts broadly define the scope of an audit, but the Acts do not limit the scope which is only measured by the auditor's

personal sense of professional responsibility. I feel confident that this will continue to be of a very high standard.

The Company Law Amendment Committee in 1926, after hearing most representative evidence, came to the conclusion—"That the great majority of companies in this country are honestly and conscientiously managed."

The report also comments on the fallacy in the idea which prevails in many quarters that fraud or other malpractices in relation to companies can be stopped by Act of Parliament. As Mr. Colin Brookes states in his book on the *Royal Mail* case: "Hard cases make bad law"—a sound axiom.

As a matter of interest, I set out to find what was the standard of honesty in this country. I put the question to an Inspector of Taxes in the City of London: "What percentage of taxpayers make correct returns of their incomes in your district?" The answer was 70 per cent. It may be that the figure for Scotland is even higher—(laughter)—but I have no figures to support it.

I thank you for your patience in listening to my remarks, and I would conclude by saying that though Mr. Morgan and I may look at the problem we are discussing from a different angle, our objective is identical, namely, true accounts. (Applause.)

THE VICE-PRESIDENT: Mr. Chairman, my Lord President, ladies and gentlemen, I should like, in common with the speakers who have preceded me, to express my acknowledgments to Mr. Henry Morgan, Dr. Voss, and Colonel Montgomery for their able contributions towards the work of this Congress. They have put before us some valuable information, and I am quite certain that when this gathering has passed by we shall all be glad to make ourselves further acquainted with what they have said, also and with the contributions which have fallen from other speakers.

I do not like to talk about myself personally, but I should like to make my position clear. I think it is only right to the Congress that I should do so. I am no longer practising as an accountant, having retired from practice about two years ago, but owing to my training and long association with the profession I am endeavouring to fulfil that useful purpose to which His Royal Highness Prince George referred in his speech the other night—to be the accountant member of some boards of companies and to endeavour to look after the interests of shareholders who have some millions of capital invested in them. I feel that in everything I do I am

indebted to the profession in which I have been brought up and in which I have passed nearly all the years of my life ; therefore, I am intensely jealous of the position of the profession and of the position of the auditor which is under discussion to-day. In any remarks I have to make I wish to point out that I have no concern whatever for the speculator. (Hear, hear.) The speculator adds nothing whatever to the production or prosperity of his country, but puts his hand into the pool in the hope that he will pull out something belonging to someone else. (Hear, hear, and laughter.) Sometimes he gets hurt in the attempt, and I shed no tears for him at all ; but do not forget that the majority of the shareholders of companies in Great Britain and Ireland—I wish to confine myself for the moment to Great Britain and Ireland—are bona fide shareholders who are helping industry and commerce by making their contributions to the common capital, and whose interests should be adequately protected. Personally, I think that in these days, having regard to the complications of modern business, shareholders are really the backbone of British enterprise.

I have listened carefully to the observations of Mr. Fitch Kemp, who bears one of the most honoured names in our profession—(hear, hear)—but I do not agree with Mr. Fitch Kemp's conclusion in one respect. I will make only this one reference to a report which Mr. Fitch Kemp brought to your notice—the report on the Companies Act, 1929, of the Society of Incorporated Accountants and Auditors—to which I was very glad indeed to put my name. I am not prepared to withdraw anything to which I have appended my signature. There is also one point on which I do not altogether agree with what my friend Mr. Keens said this morning. The question is not before this Congress whether we desire or do not desire fresh legislation. If the Government should set up a Committee to consider whether fresh legislation is desirable or not, then we have got to show that we do not fear any investigation that may be made into the manner in which auditors have discharged their duties. (Hear, hear.)

Mr. Keens referred to the last Companies Committee—the Greene Committee—and it is perfectly true that in the evidence taken, I think about the year 1925, certain practices which disclosed themselves in what I may call the disastrous boom of 1927 and 1928 were not brought before that Committee, nor could they have been. What happened during that boom has not been forgotten by the public, and has seriously disturbed public confidence, not in our profession, but in the administration of certain companies with which Mr. Morgan has so ably dealt.

I am speaking subject to correction, but I do not think that any auditor has been condemned either by a Criminal or a Civil Court since the 1929 Act of Parliament came into force. Do you not think that our proper course is to say to the authorities : " In any inquiry you make we are willing to attend and give you any assistance in our power." I do not think it is our business here at this Congress to put forward any scheme, but I do think we in Great Britain should make our position absolutely clear that we do not fear any investigation which may be made as to the manner in which our duties have been discharged.

In conclusion, I wish to refer to the observations of my friend Mr. Charles Reid on secret reserves. No one in this Congress has a greater respect for Lord Plender's opinion than I have, but side by side with Lord Plender's opinion is the statement of Lord Wright (then Mr. Justice Wright). May I read just a few lines from it with regard to secret reserves : " They may work very well in many cases, the practice has been followed, no doubt, by many concerns of the highest standing. On the other hand, it may be the subject of almost intolerable abuse. Such a system may be used to cover up negligences, irregularities, and almost breaches of faith." Surely a statement like that, coming from a Judge of the position of Lord Wright, cannot be put lightly on one side. I feel that if a case is made out for further inquiry into the administration of companies, the duties of auditors, and any analogous questions, we as members of the profession should welcome the opportunity of showing the faith that is in us, and the manner in which we have discharged our duties. (Applause.)

THE CHAIRMAN : I will now call upon Mr. Woolley to address the Congress.

MR. F. WOOLLEY, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, you will I am sure quite understand me when I say that one feels one's position a little in following immediately after a speech by Sir James Martin ; but I do feel that not only this Congress, but that the responsible commercial and financial interests will appreciate the further service that has been done by the combination of the papers we have before us this morning, and so far as Great Britain is concerned, the comprehensive paper which Mr. Morgan has presented to us.

Mr. Morgan takes a broad and generous view of the duties of auditors. He makes no attempt in this paper to limit them by somewhat circumscribed language in an Act of Parliament ; he places upon those duties a moral consideration which I think we shall all agree must always find a

very strong place in our consideration of these matters.

The discussion has centred very largely upon the question of reserves, to a lesser extent upon the contents of profit and loss accounts, and in some measure on the question of legislation. I will express one opinion only in regard to legislation, and it is this : I think it is generally recognised that the 1929 Act has been found insufficient in certain respects from the point of view of the conduct of companies, the publication of their balance sheets, and the responsibilities of auditors, and so long as we are clear as to what those defects are then there need be no hesitation in pressing for any new legislation which may be necessary to put the matter upon a satisfactory footing.

A subject about which I would desire to offer just one or two brief further observations is that of reserves, and I am speaking only of that class of reserves which we regard as being free reserves. A somewhat loose interpretation of a single sentence in Lord Justice Buckley's judgment in the case of *Newton v. The B.S.A. Company* seems to have led to an exaggerated view as to the liberty which can be taken in the drawing up of balance sheets. Prudence is always required in the valuation of assets and statement of liabilities—prudence to see that assets are not over-valued and that liabilities are not under-stated ; but if a company has a free reserve which is equivalent to any considerable proportion of its capital hidden away in the expression of " general creditors " then it can scarcely be said that such a balance sheet discloses all the material facts in relation to the financial position of the company, or that it is a true and correct balance sheet. I feel myself that if it is acknowledged that the utilisation of reserves for purposes of dividends should be disclosed then it is very difficult indeed to apply any other rule to the creation or the existence of reserves. (Applause.)

THE CHAIRMAN : I will now call upon Mr. Ashworth to address the Congress.

MR. ROBERT ASHWORTH, F.C.A., F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, I do not intend to follow the lead of Mr. Furnival Jones in preaching against preaching, but will content myself with dealing as far as possible with a few of the facts.

In the first place, I should like to join in congratulating Mr. Morgan on the excellence of his paper. It is not only an excellent, but courageous paper, and it reveals just that quality of courage that our profession needs so much to-day if we are to preserve the utmost integrity in company administration.

The public has learned to rely upon the reports and certificates of professional accountants, and we must be extremely careful lest that reliance turns to distrust, for while human nature remains as it is directors will always endeavour to put the best possible face upon their published balance sheets and accounts and use their full persuasive powers to get a clean report from the auditor upon them. We must at all costs avoid taking the line of least resistance if we desire to retain the confidence of shareholders.

I submit, Mr. Chairman, that it is no part of the duty of the auditor to protect directly the interest of shareholders. His duty to my mind, as evidenced in the cases which Mr. Morgan has cited, is to place the shareholders in a position to protect themselves. This he will do if he conscientiously carries out his statutory duty to report as to whether or not in his opinion the balance sheet is properly drawn up so as to show a true and correct view of the state of the company's affairs, according to the best of his information and the explanations given to him and as shown by the books of the company. The auditor cannot be doing his duty if the balance sheet does not in fact show the true and correct view of the company's affairs.

As Mr. Morgan rightly states in other words, if the auditor carries out his duty with regard to the balance sheet without any mental reservations he cannot fail to give proper attention to the profit and loss account and the question of secret or internal reserves.

Then again, there are other interests in respect of which the auditor has no statutory duty, but which he cannot, in my opinion, afford to dismiss from his consideration lightly. There are the interest of the general investing public who may be induced by the published balance sheet and profit and loss account and the auditor's report to become shareholders, but who would not, or might not have done so, had they not relied upon the auditor's report. Also, there are the interests of the creditors to consider. While it is well known that where there is doubt as to giving initial credit the creditor very often desires to go behind the published balance sheet and accounts, yet creditors rely to a great extent upon the published information and auditor's report in deciding as to the maintenance of that credit. I should have liked to have heard Mr. Morgan deal with the auditor's responsibility in both these connections.

Finally, let me say, Mr. Chairman, that Mr. Morgan has done a great service to the public in once again throwing the searchlight upon the bogey of secret or internal reserves, for there is no doubt that, while in

many cases the creation of these internal reserves is effected in the supposed best interests of the concern, yet they are utilised to an alarming extent to cover up the effects of bad management.

If a reserve is necessary for any purpose which it is considered not in the interests of the company to publicly disclose, there is nothing, in my opinion, to prevent it being disclosed as a general reserve, or reserve for contingencies, unless the utilisation of such reserve is also to remain undisclosed, which, in my opinion, should on no account be permitted. There cannot be, I think, any justification for such items as "sundry creditors and sundry balances," or "sundry creditors including reserves for contingencies" appearing in any balance sheet when they are used for the purpose of concealing reserves.

If it is seriously contended that the justification for the creation of secret reserves is that the real position is better than that disclosed by the published accounts and balance sheet, then it is quite logical to assume that the non-disclosure of the utilisation of these reserves cannot be justified on the grounds that the published accounts and balance sheets would then show a better state of affairs than in fact really existed.

Non-disclosure of internal reserves and their utilisation, with very few exceptions, is more in the interests of the directors than in the interests of the shareholders and I earnestly believe, Mr. Chairman, that if our profession were to take a stronger line on this question there would be fewer failures of businesses from bad management, which in my opinion is a far more serious menace to company business to-day than trade depression. (Applause.)

THE CHAIRMAN: I will now ask Mr. Wilson Bartlett to address the Congress.

MR. WILSON BARTLETT, F.S.A.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, yesterday morning I found a few minutes to spare and I endeavoured to make a last survey of these three most important papers which have been submitted to us for discussion this morning. Whether the time chosen was inappropriate, or whether it was in consequence of it being the morning after the night before, I know not, but my mind refused to function and travel in the direction I desired. Instead of reviewing the Companies Acts since the year 1862, disjointed words and phrases continually recurred to my mind; for example, trust and trustworthiness which we had on Monday morning—co-operation and competition which we had on Wednesday night—a game of football—accountants are the referees in the game

of commerce, and also from my friend Colonel Montgomery, you wear too many clothes. After a short struggle I allowed my mind to wander and found myself making instead of a review of the Companies Acts a review of the game of football, and that review commenced with an incident on the playing fields of Rugby in the year 1823 when William Webb Ellis caught the ball and ran with it against all the rules of the game. In those early days the game was far different from that which is played to-day, it was a game of hard scrummaging; pushing, no heeling back, hacking, tripping—they were all within the laws; and another small point which may be quite unknown to the present generation, the old maul in the goal. But by a gradual and judicious amendment of rules the game as played to-day has been evolved, and in memory I once more stood on the playing fields of Rugby and watched that wonderful centenary match between the four home countries when 30 players and a referee combined to give a perfect exhibition of co-operation and competition. This was accomplished as a result of amended rules and a strict and logical interpretation of those rules both by players and the referee.

Surely, Mr. Chairman, this analogy can be applied to commerce. In commercial life during the last few years, especially since 1925-1926, we have had some tripping, some hacking and some mauls in goal. The rules of the game represented by Acts of Parliament have been found, in my opinion, to be inadequate in certain respects. No one desires panic legislation, but I would suggest that the time has now arrived when representatives of commerce and professional accountants should welcome any inquiry which may be set up to ascertain whether any amendments to the present Companies Acts are required in order that directors and shareholders should know exactly their duties and responsibilities, and also that professional accountants may know how those rules and regulations should be interpreted.

In conclusion, Mr. Chairman, I would suggest that, in Great Britain especially, professional accountants and the investing public as a whole should congratulate Mr. Henry Morgan on his tenacity and courage for the firm stand he has taken during the last two or three years, and I am sure that the discussion this morning will considerably help towards the attainment of his wishes. (Applause.)

MR. F. LINDSAY FISHER, C.B.E., F.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, Mr. Morgan's paper on the auditor's responsibility divides itself under three heads: past, present

and future. As regards the past, some of us have been through those dark ages to which Mr. Morgan refers ; perhaps not quite back to 1862, but at any rate a good deal further back than the thirty years to which he referred in his opening remarks. Some of the enactments and dicta to which reference is made, whilst they were familiar enough at the time, have been superseded to such an extent that it is refreshing to have them recalled to memory. It is wonderful, though, how well some of these old judgments have worn and continue to wear. Judges, though frequently, I suppose, they have no training in accounts, have from time to time dropped words of wisdom which show remarkable foresight, and always sound common sense.

There is hardly an instance in any of the leading cases where one would wish to change a single expression used by the Judge—even in the light of the enormous development which has since taken place. I was interested, however, in being reminded of a remark of Mr. Justice Lindley in his judgment in the *London and General Bank, Ltd.*, case in 1895. He said : “ A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them, or some of them, to ask for more. Information and means of information are by no means equivalent terms . . . an auditor who gives shareholders means of information instead of information in respect of a company's financial position does so at his peril, and runs the very serious risk of being held, judicially, to have failed to discharge his duty.” His words are very sweeping, if construed quite literally. Nowadays one frequently sees a qualification in an auditor's report to members such as “ provision has not been made for depreciation ” ; such a remark would obviously be means of information instead of information in respect of a company's financial position.

When Mr. Morgan comes to the second part of his paper, namely, the present time, he is still on fairly safe ground. He gives us extracts from recent judgments and opinions from leading counsel and others, which we in England have not yet had time to forget, and which must be of interest to those members of our profession who come from abroad. Mr. Morgan also expresses some views of his own in this second part of his paper. For the most part I expect the majority of those present will endorse what he says. In fact the general trend of his remarks is here so orthodox that it seems invidious to fasten upon a sentence here and there which one would like to have seen expressed differently. But in one or two instances I would venture to express a different opinion. As an

example, may I refer to Mr. Morgan's personal opinion on the subject of disclosure of a secret reserve. After stating that leading accountants have expressed the following view: "provided the creation, existence or utilisation of a reserve is noted in the accounts, the non-disclosure of the actual amount is justifiable," Mr. Morgan goes so far as to give his personal opinion that "it is not consistent with the statutory form of the auditor's certificate."

I should personally much rather accept Lord Plender's remark (quoted by Mr. Morgan) which was as follows: "In my opinion directors should be entitled, in the interests of the company and its shareholders, to make reasonable provisions for contingencies and should be allowed discretion in so doing *without necessarily being required to disclose the amount of the provisions in the balance sheet.*"

Later in his paper, Mr. Morgan appears to me not to differentiate between trading and capital losses which may have been suffered by a subsidiary. He stated: "If shares in a subsidiary company were shown at cost, it would be *true*, but if a part of the capital of such subsidiary company had been lost, judged by sound commercial and accountancy principles, the item would not be *correctly stated.*" "It is my view," said Mr. Morgan, "that, if the losses of a subsidiary are not dealt with by reducing the amount at which the investment appears or by making proper provision on the liabilities side of the balance sheet, the auditor should call attention thereto in his report."

Be it noted that Mr. Morgan does not limit his remarks to trading losses of the subsidiary, in fact it would almost seem that he is referring specially to capital losses—his remark comes under the heading of balance sheet, not profit and loss account. I should like to ask Mr. Morgan if he would consider it an auditor's duty to require re-valuation, for example, of the figure at which goodwill stands in the balance sheet of the subsidiary. If so, apparently he and Sir Josiah Stamp are of one mind, but I think they stand almost alone in their view.

It is not, however, until Mr. Morgan comes to his third division, namely, the future, that there is room for serious divergence of opinion. Mr. Morgan, and the society of which he is such a prominent member, plead for new legislation. It is true that in his paper Mr. Morgan quotes only the concluding paragraph of a report of his Society, which states: "The only effective action must be by amending legislation." Mr. Morgan goes on, however, to give his personal views as to the form which such amending legislation should take, one item being "The duties of the

auditor." I venture to differ fundamentally from Mr. Morgan and his Society. I submit that so far from the only effective action being necessarily amending legislation, the wisdom of our legislators and their advisers has been shown by their restraint. You cannot make auditors, or anyone else, efficient by Act of Parliament. If an auditor conscientiously carries out his duties, the less he is hampered by rules and regulations the better. What is proper in one case may be quite wrong in another. I sincerely hope that, when the 1929 Act is amended, our legislators will continue to show their wisdom by saying as little as possible on the subject of "The duties of the auditor."

Before I sit down I should like to refer very shortly, if I may, to a letter from a South African accountant. He refers to Mr. Morgan's paper, and expresses the hope that one point may be discussed in connection with the subject. It appears that South Africa has fallen behind England in the matter of placing the auditor's report on the face of the balance sheet. There it is still the practice, apparently, for auditors to refer, in their certificate on a balance sheet, to a separate report. It would seem that this is an instance in which Mr. Morgan is right in his view that legislation is a good thing, because we here are not allowed to adopt this most undesirable practice. (Applause.)

MONSIEUR ALEXIS ROCHE (France) : Mr. Chairman, my Lord President, ladies and gentlemen, the French Delegation think that it will interest the delegates to the Congress to know the actual position of the auditor's responsibility in France. (1) *The obligation for all Sociétés Anonymes to have their accounts checked.* The obligation for all limited companies to have their accounts checked is the result of the rulings of Articles 32, 33, 34 and 35 of the Law of 24th July 1867, which reads as follows : "Article 32. The annual general meeting appoints one or several auditors—partners or others. These auditors are instructed to draw up a report for the general meeting to be held the following year on the standing of the company, the balance sheet and the accounts submitted by the Board of directors." The resolution covering the approval of the balance sheet and the accounts is null and void unless it has been preceded by the auditors' report. "Article 33. During the three months preceding the date provided for in the bye-laws for the general meeting, the auditors have the right, whenever they deem it advisable in the common interests of the company, to examine the books and acquaint themselves with the operations of the company." In urgent cases the auditors have at any time the right of convening a general meeting.

“ *Article 34.* All companies shall prepare every six months a statement on its position, showing assets and liabilities. This statement is to be placed at the disposal of the auditors. An inventory shall also be taken annually in accordance with Article 9 of the Commercial Code. This inventory shall show the value of movables and immovables as well as all the debts (assets and liabilities) of the company. The inventory, the balance sheet, and the profit and loss account are to be placed at the disposal of the auditors on the fortieth day at the latest before the general meeting.” “ *Article 35.* At least a fortnight before the general meeting every shareholder has the right to acquaint himself with the inventory and the list of shareholders at the head office of the company. Every shareholder is also entitled to a copy of the balance sheet, including the inventory and the report of the auditors.”

The auditors constitute the controlling factor in the interests of the shareholders. The appointment of the auditors for the first business year is an essential condition of the regular constitution of the company (Article 25, Section 1, of the law of 24th July 1867).

The general meeting alone has the power to elect the auditor or auditors, whose name cannot appear in the bye-laws of the company. The particular object of this ruling is to prevent the founders from nominating the persons whose duty it will be to control their operations as directors. The auditors are the mandatories of the shareholders, and can accordingly be dismissed by the general meeting. The law does not require that the auditors be either shareholders nor belong to any particular profession, but the functions of auditors cannot be performed by one of the managers of the company. Many French companies appoint as auditors professional “ *experts-comptables* ” (certified public accountants).

The essential duty of the auditors is to draw up a report for the annual general meeting of shareholders on the standing of the company, the balance sheet and the accounts produced by the Board. Should this report not be read, the approval of the balance sheet and the accounts by the shareholders is null and void. The auditors shall also convene a general meeting in urgent cases.

II. *Responsibility of Auditors.*—The auditors assume a dual responsibility, i.e. firstly towards the company and secondly towards third parties.

(a) *Responsibility towards the Company.* Auditors, just as directors, are mandatories of the company, and it is in this quality that they are responsible towards it. Article 43 of the law of 24th July 1867 leaves no room for doubt in this respect, in that it states that “ the extent and the

effects of the responsibility of the auditors towards the company are determined by the general rules of the mandate." The auditors are responsible to the shareholders for their mistakes or negligence, and the Tribunal de la Seine has decided that they cannot plead incompetence with a view to avoiding legal measures instituted against them. They are responsible only for their personal mistakes and not for those committed by directors. It is admitted that the *quietus* given to the directors covers also the auditors. Any mistake committed by an auditor involves his *civil* responsibility, and, under given circumstances, his *penal* responsibility, e.g. in the event of any criminal act of which the directors may have been guilty and which has not been duly reported by the auditors (Cour de Cassation, judgment of 28th April 1888). The limitation of the responsibility of the auditors is a period of three years, if it is a criminal case, and thirty years in other cases. (b) *Responsibility towards third parties.* Auditors are likewise responsible to third parties for their actions. At first glance it may appear astonishing that auditors are obliged to consider anybody else but the companies for whom they are acting as mandatories. In point of fact the law of 1867 does not provide for any responsibility towards third parties. However, almost all doctrines and jurisprudence admit this responsibility towards third parties; in practice the responsibility cannot be avoided. The legal foundations of a conception of this nature originate from Article 1382 of our Civil Code, which has a general bearing upon the matter. It reads as follows:—"Every act whatsoever of a person that harms any other person places the former under the obligation to make amends." All the authors who have dealt with the question of limited companies have published many articles on the matter.

III. *Alterations now being considered with regard to the duties of auditors of Sociétés Anonymes.*—The present organisation and execution of the control exercised by auditors is considered by the French legislator as insufficiently effective generally. Public powers are endeavouring to improve such inadequate control, and at the present moment a legal motion is under consideration to govern the selection and duties of auditors of limited companies. Besides this, a proposed law, which has been submitted to the Senate, tends to render the control more strict. It has been specially provided for in the following proposal.

A. *The Selection of Auditors.*—(1) That, in the case of companies whose shares are negotiated publicly, the functions entrusted to auditors shall be performed by one or several auditors appointed by the President of the Tribunal de Commerce in whose jurisdiction the headquarters of the

company are situated, after a request to this effect has been handed in by the chairman of the board of directors. (2) That these auditors shall have obtained the diploma of "Commissaire vérificateur de Sociétés." In regard to this diploma the rapporteur of the proposal for a new law states as follows:—"In view of our inability to lay down here the conditions to be fulfilled to obtain the diploma, we beg to request the Conseil d'Etat to decide the issue, and it is a decree governing the rulings for public administration which will determine the rules for comptrollers of limited companies. As stated above, the decree of 22nd May 1927, and the ministerial resolutions which followed it, require of candidates the diploma of 'Experts-Comptables brevetés par l'Etat,' a period of five years' apprenticeship, and to pass a very stiff examination, the programme for which appears to be exceedingly well drawn up. Practice in certain other professions constitutes for those engaged in them adequate guarantee as regards morale and competence. E.g. former financial inspectors, arbitrators at the Tribunal de Commerce de la Seine, experts recognised by the Tribunaux de la Seine, ex-inspectors de l'Enregistrement, inspectors of direct and indirect revenues, practising auditors, all appear to be qualified to have the diploma conferred upon them without passing a further examination. Hence the decree could require candidates to pass stipulated examinations or to produce equivalent diplomas."

B. *Remuneration*.—That the emoluments of auditors be determined by the chairman of the Tribunal de Commerce. The remuneration would vary according to the scale upon which the company to be controlled does business, the difficulty of the work and the responsibility it involves, &c.

C. *Performance of Duties*.—That the auditors should be controllers whose duty it shall be to check the different items of the balance sheet in order to assure themselves that they are true, to examine the inventory in order to determine whether or no it is correct as regards quantity and figures, to verify the accuracy of the receivables entered in the assets, to check whether or no the values given to immovables and to the portfolio are true, &c.

D. *The Term of Office*.—That the auditors be appointed for a period equal to that for which the board of directors has been elected, or generally six years.

The foregoing is a synopsis of the present state of affairs in France as regards the question of "Commissaires vérificateurs de Sociétés Anonymes," their responsibility, and the changes that are now under consideration. (Applause.)

MR. WILLIAM CASH, F.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, in the few remarks which I desire to offer this morning I want to avoid, in the interests of time, going over points which have already been covered by earlier speakers, and to make my remarks as brief as possible. I should like to join with other speakers in acknowledging the value of the papers which have been placed before us this morning, and I am dealing particularly with Mr. Morgan's paper. I would say with regard to that that I think we should all agree it is a careful and useful summary of the points which affect the practice of accountancy to-day. Taking those points briefly which arise on the paper, he talks about our responsibility, particularly in relation to the profit and loss account, and I think I am not misinterpreting him when I say that I gather his views to be that to-day that responsibility extends both in fact and in practice to the profit and loss account. Mr. Morgan uses a number of phrases with which we should all be in agreement. In regard to the profit and loss account, he talks of "actual earnings" on page 515, and of "correct results as a whole," that the profit and loss account should show "actual results," that it should be the "profit earned," and that it should be on "sound and proper lines." We all agree with that. The difficulty comes when you consider whether these matters could be better defined and regulated by Act of Parliament. I would just interpose this one observation, that where accounts are untrue, or statements are misleading in certain circumstances, there are remedies which exist outside the Companies Acts, and those remedies have been applied and have produced serious results for those who have been responsible for such misstatements.

Now with regard to the profit and loss account again, while it is undoubtedly true that the earning capacity of a company is the best test of its value in the majority of cases, we can all think of cases where mere ownership of itself may be of real value apart from earning capacity.

I turn now to a subject which has been very much in the public eye of late—that is, the question of secret reserves, or, as one speaker has termed them, I think, free reserves. I think there really is a difference between the two definitions. I do not think they are the same thing. My friend, if I may so call him, and colleague in a sense, Sir James Martin, has given us some very valuable observations to which we will all attach the very greatest possible importance. He read to you from Mr. Morgan's paper on page 501 part of the remarks there quoted of Lord Wright ; but I think you must read those remarks as a whole, and while Lord Wright says that secret reserves may be a matter of danger he also says in the

preceding words that they may be of the greatest value, or words to that effect ; you can read the actual quotation for yourselves.

On the question of the disclosure of such things as secret reserves, there are points, I think, which we must not overlook—that the mere disclosure may be of no real value to the shareholders. Take, for example, such a case as this : I know that Mr. Morgan appears to deal specially with the question of banks. Imagine a large contingency fund in the hands of a bank. Would it be of the slightest value to the shareholder to know that that contingency fund was a quarter of a million, half a million, or one million ? How can he tell, and how can he know whether that contingency fund is really required, and to what extent, in relation to the assets ? This question of secret reserves is closely bound up with the profit of the year, and I suggest to you that the question of such disclosure is very largely a matter of degree and that it would be extraordinarily difficult to control such a point by Act of Parliament. Income-tax, for example, recovered in a year is a receipt of that year, but it may be an exceptional matter, and when we come to deal with such general terms as extraneous receipts and extraneous expenses or exceptional receipts and exceptional expenses, I think again the accountant may be placed in a very difficult position.

I should like here, taking rather a different line, and purposely, from some of the other speakers, to give you some examples of the sort of difficulty that would arise if you attempted to define these matters by Act of Parliament, and the burden which you would place on the auditor if an attempt were made to bind him by specific provision. Take the question of the stock reserve or the written-down value of stock. Are those to be regarded as a secret reserve ? Is it the same thing if they are treated in one way or in the other ? Take the reserve in the hands of a subsidiary company or the undivided profit of a subsidiary company : Is it a secret reserve ? Take such a case as a guarantor of a capital issue who may think it wise to make provision for such a matter : Is it an extraneous debit ? Is it an exceptional receipt if it is not required and is brought back again ? I think there is a tendency to regard companies as all carrying on the business of manufacture or trading. Companies vary enormously in their operations and in their character. Take such questions, for example, as a direct guarantee either as regards the fulfilment of its duty on a particular machine or constructional work extending over a period : Is that a secret reserve ? It may or may not be required in the future, when the question of the completion of the guar-

antee expires or the secret reserve or reserve is brought back again. Take the question of a shipbuilder or bridgebuilder who has to apportion his profits as best he can until the final period of a contract, and who makes reserve for the completion of the work. Take the question of exchange reserves : Is it to be assumed that this would not be secret if the reserve were actually required in the year ? And then, if the subsequent appreciation of local currency arose, and a credit resulted, is that an extraneous receipt, or is it the profit of the year ? Take the reserve for suspense interest : That is a thing with which we are all familiar every day. Where doubt is expressed of the solvency of the debtor : Is that again a case where the transfer into or out of such a reserve would have to be specially dealt with ? Mr. Morgan has pointed out the difficulties which arise on the legal position, and I do not think these must be entirely disregarded. Assets of the subsidiary company are not assets of the holding company in law. As has been pointed out by other speakers, the liabilities of the subsidiary company are not entitled to rank against the assets of the holding company. I suggest that you might get a misleading impression of a company's business if these things were treated by Act of Parliament in a particular way.

I intended to have said a word or two with regard to the final recommendations which Mr. Morgan makes on page 518. We should all agree that "adherence to sound accountancy principles" is to be desired, but I am not at all clear that that adherence can be achieved by our legislatures.

MR. RUSSELL KETTLE, F.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, Mr. Morgan's paper is largely devoted to a comprehensive review of the auditor's responsibility in two particular and important matters—firstly in relation to the creation, existence and utilisation of secret reserves, and secondly in relation to what constitutes a sufficient and adequate disclosure of annual results in a profit and loss account.

The prominence given to these questions in the press and in public discussion as a result of the *Royal Mail* case appears to have created an impression—not entirely absent from Mr. Morgan's paper—that auditors took little or no cognisance of the composition of profit and loss accounts, except to see that the balance properly formed part of an accumulative record of revenue results on the balance sheet, and further that auditors failed to appreciate the significance of secret reserves as a factor in considering the financial position disclosed by the balance sheet.

It is, of course, not correct to suggest that auditors were unmindful of their responsibilities in regard to these questions prior to the *Royal Mail* case. There is, however, a limit to such responsibilities. On the one hand we are bound to have regard to statutory requirements and their interpretation from time to time by decisions of the Courts and judicial dicta. On the other hand we must give due consideration to decisions of directors within the wide discretion in the conduct of business which the legislature has seen fit to leave to them, subject only to such domestic regulations not contravening the statutes as shareholders may themselves adopt in memoranda and articles of association, or by resolution of a requisite majority of their body. These dual foundations of law and custom upon which administration of public companies rests should not be lost sight of when considering the issues raised by Mr. Morgan. Auditors are not responsible for the policy of the directors, neither have they any part in the management of the company's business. An auditor frequently feels that more information might well be afforded to shareholders. He is, however, not responsible for paucity of information in published accounts, otherwise properly stated, if the directors within their legal rights and in the honest exercise of their discretion, do not follow the auditor's recommendations. An auditor who confuses his duties with those of directors and becomes a law unto himself would be setting a somewhat dangerous precedent and increasing his responsibility in the eyes of shareholders to an extent which, unless the law be amended, was never intended or contemplated. It is well, therefore, that in considering our position we should keep in mind fundamental principles however much we individually may criticise existing legal requirements interpreted in the manner I have indicated.

In summarising the present position of the auditor in these brief remarks I do not intend to suggest that auditors should base their duties on purely technical grounds. On the contrary, no auditor would dispute the principle laid down by Mr. Morgan that the balance sheet and profit and loss account should not convey a misleading impression of the state of affairs of a company or as to the results of the company's business. The object of accounts, however, is viewed by different persons from different angles, and it must be admitted that the limitations of published accounts prevent many of the supposed objects from being satisfied. For instance a large number of shareholders look to a balance sheet to show what the fixed assets are worth from a realisable point of view and they do not appreciate that a balance sheet is not framed with this object, but is intended to

show how the capital has been expended and maintained to carry out the purposes for which the company was formed. Again the values of current assets such as stock in trade and debts are matters of estimate and opinion dependent upon a variety of circumstances and conditions and are not capable of exact statement. Commitments and accrued provisions may often be viewed in more than one way in attempting to assess a company's liabilities. The profit and loss account is not necessarily an index of normal earning capacity, nor is the balance required to be arrived at in the same way as figures of profits certified for prospectus purposes.

Unless the law be altered the auditor's attitude in regard to secret reserves and their application must continue to remain a matter for his judgment, having regard to the circumstances of each particular case. We must not become imbued with the idea that such reserves are without merit and inimical to the interests of shareholders or regard them as evidence of criminal intent by directors. Counsel who were consulted by the Institute of Chartered Accountants in 1931 were well aware of the legal and practical difficulties of laying down any rules capable of universal application even in the light of the observations of Mr. Justice Wright in the *Royal Mail* case. The most that can be definitely said, as Lord Plender has pointed out, is that the creation, existence and utilisation of secret reserves must at least be indicated by suitable wording and that except in comparatively rare cases the amounts of such reserves used in relief of losses or by way of supplement to profits should be stated. Mr. Morgan, however, goes further, and suggests that no balance sheet or profit and loss account can be reported upon as true and correct unless amounts in all cases are stated, and unless this is done he considers the auditor's report should contain the qualification: "Subject to the non-disclosure of the amount of the reserve referred to in the balance sheet or profit and loss account" as the case may be. Such a qualification might probably be regarded by shareholders solely as an attempt on the part of the auditor to protect himself, but it is doubtful if shareholders would regard it as adding anything useful to information already indicated by the accounts themselves. In fact, Mr. Morgan's paper might well be regarded as an appeal for legal restriction of the responsibilities of auditors by attempting to curtail the exercise of their judgment in circumstances and conditions which no Act of Parliament could hope to deal with by legislative enactment. It might be asked whether the interests of shareholders would be furthered by such a course.

There must be general agreement with the view expressed by Mr. Morgan that the profit and loss account should show the true—or as I should prefer to call it—the appropriate balance of profit or loss for the period covered by such account. It must be recognised, however, that frequently the apportionment of profits and charges to one particular financial period involves considerations not always easy of solution and differing views may each have much to commend them. Provided there is consistency in the principles adopted year by year in arriving at annual results, the balance may be said, for practical accounting purposes, to be correctly compiled. We are perhaps on more difficult ground when considering the question of abnormal and extraneous profits and losses properly arising within the year under review. I will content myself by saying that it is easy to prescribe rules of a wide and general nature, but their ambit and application are frequently highly controversial and a strict compliance with the letter might result either in a ridiculous situation or in defeating the substantial object sought to be achieved. Professional auditors know what items of this nature require reference in the narrative of the account to avoid a misleading impression, although the separate disclosure of amounts may not be capable of being insisted upon or justify a qualification in the auditor's report.

May I, in conclusion, add my expression of appreciation of Mr. Morgan's paper. Whilst we may not all agree with his views, we realise he is prompted by the desire we all share to improve the form of presentation of accounts, so that in spite of their limitations they may be free from anything which, in a business sense, offends against commercial morality. (Loud applause.)

MR. L. J. DAVEY, F.L.A.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, the importance of this subject, and the very lucid papers which have been submitted, do not encourage me in the hope that my contribution to the discussion will contain any germ of originality. The contribution made by Mr. Keens expressed so adequately what I had in mind that I feel I cannot possibly add anything to what he said. At the same time I am very glad to have this opportunity, as a younger member of the profession to which Mr. Keens has referred, of adding my modest contribution to the deliberations of this Congress.

Legal responsibilities have been fully discussed in these papers. Each of us realises only too well the defects in the law as it exists to-day, defects which perhaps will never be entirely remedied until the drafting of the Act is entrusted to an accountant. Furthermore, each of us realises that amendments of the law are only attained by a slow and tedious process,

and in that respect Mr. Keens demonstrated only too well how slowly the law operated and how slowly alterations in the law can be effected. But let us turn to the practical aspect, and here I see our opportunities. To quote from Mr. Morgan's concluding paragraph, "we must use our influence, and direct our efforts, to securing such improvement in the law and practice of accountancy as will ensure that the accounts which we audit are true and correct and are sufficiently informative to prevent misleading impressions being conveyed as to the state of affairs of a company and the result of its operations."

In brief, it is generally conceded, I think, that practice must progress in advance of legislation and an auditor, if he is to fully discharge his duties, must go further than a mere compliance with the letter of the law, and must use his personal judgment as to what matters need classification or amplification. Now I submit, Mr. Chairman, that to leave matters of this sort to be decided simply by individual opinion, throws a great onus upon the auditor. I speak now as a young practitioner who has not yet acquired that nice balance of judgment which comes only from long experience. After all, moral values are not always the same, even among auditors. If auditor A., contrary to the views of the directors, is of the opinion that a balance sheet, although perfectly in accord with the law, needs some alteration or explanation, while auditor B. sees no need for such alteration, then A. probably loses a client and B. gains one. A mercenary view, perhaps, but I use it to illustrate my point, which is that there should be uniformity of practice, and I suggest that this can only be achieved by the drawing up, by the leaders of the profession, of a code of rules dealing with some of the more important questions which it is recognised that the law has failed to clarify. By so doing, two purposes would be served. First, uniformity of procedure, and, second, the removal of what I believe is a growing tendency on the part of the public generally to regard published accounts with suspicion, as being either uninformative or actually misleading.

Mr. Chairman, I should like, in conclusion, to misquote Tennyson and the previous speaker, and say that we, the younger members of the profession, have faith and we desire to know. (Applause.)

MR. E. F. JEAL, B.Sc. (Econ.), B.Com., A.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, I have noted the tremendous and stimulating fearlessness which Mr. Morgan has demonstrated in the closing remarks of his most excellent paper. I wish, if I might, to reinforce one of his remarks. He says that over the last 20 years there has been a distinct tendency to reduce the amount of information

given. He uses this remark in connection with the development of mergers. I have recently been making a study of the published accounts of a certain type of business in this country covering about 40 years, and I can honestly say from this inquiry that quite apart from the question of mergers there has been a distinct tendency for the details shown in the accounts to be reduced. I have also noted what enormous attempts are made to obscure the position, which obviously should be quite clear. From Dr. Voss's paper one considers the potentialities of the law, and although I think that for continental purposes the law may be a useful adjunct, I doubt its effectiveness in this country, where we rely by tradition more upon men than upon laws made by man. I support this view by a reference to American procedure. I think those who have experience of American and Canadian accounts will agree with me that they are very much clearer than any others. Yet, so far as I know, the law on the subject in the United States is much less rigorous than in many other places. The reason seems to me to lie in the fact that some very distinguished pioneers, like Sir Arthur Lowes Dickinson, went over there and established a British tradition for clearness in financial statement. Furthermore, in the United States I believe the chief accountant, usually called the Financial Controller, has wider administrative rights and duties than is the case in some other places. Therefore what I would suggest to this Congress is that possibly one might modify the law by arranging for the chief accountant to share in a fiduciary sense the responsibility of the auditor for the financial statement. That would increase the status of the financial controller, and I think it is highly desirable. I do not think we should prescribe the exact detail, but the auditor and the financial controller should be responsible that the statement is reasonably clear. Thank you.

MR. H. G. HOWITT, D.S.O., M.C., F.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, as time is short I will not deal with the generalities on which I had proposed to make a few remarks, but will go straight to what I consider the essential points of the matters we have been discussing. The problems resolve themselves largely into three categories—the profit and loss account, secret reserves, and subsidiary companies. It is perhaps well, therefore, to consider separately, under each head, what has been achieved to date—not to belittle it—what remains to be done, and the best way of achieving it.

Profit and Loss Account.—We are all, I hope, agreed : (a) If the profit and loss account does not show earnings it must not be so worded as to convey the impression that it does show them. (b) If it does purport to

show earnings, extraneous items, if material, should either be indicated or shown separately as occasion demands. And (c) as between different accounting periods revenue should be stated on a reasonably uniform basis. An auditor who does not see that such rules are complied with does so at his peril. That position, therefore, represents a substantial advance and one which it would have been difficult to attain by legislation—a fact which it is well to recognise.

What further can be done ? We might specify even by legislation that certain items must be shown separately, e.g. income-tax, depreciation, income from investments and subsidiaries. Personally, I should see no objection to this, and we shall watch with interest the German experiment in this direction. At such gatherings as this we can even clear our minds as to what we mean by profits and losses, but can such definition be codified in a manner suitable for an Act of Parliament ? It would involve laws as to methods of depreciation, stock valuations, &c., which I think can never be adequately treated by such means.

Secret Reserves : We have at least drawn a line between the fixed and the floating position, and in regard to the latter we are agreed that free reserves among creditors, if substantial, must either be indicated or disclosed as the occasion demands ; also that reserves written off in any year against floating asset values must be reasonable in all the circumstances ; also that reserves must not be drawn upon to bolster up earnings unless disclosed.

Again, what further remains to be done under this head ? Can hard and fast rules really be devised to decide in a complicated balance sheet when a provision ceases to be a liability and becomes a reserve ? Can rules be laid down for valuing floating assets—or, more difficult still, can fixed assets be required to be valued in a manner to disclose secret reserves, if any ?

Subsidiaries : We are agreed that profits earned by subsidiaries prior to their acquisition may not be taken to the profit and loss account of the parent for distribution by it as dividends. We are also agreed that if dividends in any year from subsidiaries exceed in total their earned surplus for that period to an extent calculated to mislead, the facts should be disclosed.

What further can be done here ? As accountants we might like to see all subsidiary profits and losses, so far as ascertainable, brought into the parent accounts, but the complications in some cases, arising as they do out of the varied nature of holdings, and even out of variations in account-

ing method between the companies concerned, are so considerable that here again it is doubtful whether an Act of Parliament could effectually specify them.

My comments are not intended to be controversial or destructive. On the contrary, we all realise there is much to be done, and we all know the law can, and will from time to time, be improved, though, I think, only in general terms. For myself, however, I would prefer a little more effort by the commercial and accounting community on these particular points before we try further, and, perhaps hasty, legislation. But the effort must be a real effort, and the future is largely in our hands. If any of us is party to the issue of accounts which offend against the reasonable standard of public opinion—indeed, if as a profession we do not try continually to improve that standard—we are asking for legislation, and we shall deserve what we get. At the same time, it is no good thinking these matters are simple, and can be solved by rule of thumb. It is easier to call generally for improvement than to draft the rules required. (Applause.)

THE CHAIRMAN : Our President, Lord Plender, has kindly consented to say a few words.

THE PRESIDENT : Mr. Chairman, ladies and gentlemen, with much of what is said in Mr. Morgan's paper I am in entire agreement. He has prepared it with great care, has marshalled his authorities with clearness, and his conclusions, whether we agree with them all or not, are entitled to consideration and respect. I congratulate him on his contribution, which is of great value.

There are two aspects of his paper which you will perhaps allow me to refer to very briefly and in a practical way, as time is short.

First, the auditor's position as regards transfers to or from profit and loss to inner provisions or reserves. If directors in the honest exercise of their judgment set aside a sum or sums for unmaturing but possible contingencies to which the business is subject and which they think are necessary in the best interests of a company, few if any auditors would question the desirability, if not the obligation, to see that the profits were stated after referring to such provisions having been made. It does not follow, however, that an auditor in reporting on the accounts would feel it to be his duty to state in his report the actual amount so set aside if the directors thought that in the company's best interests the amount should not be disclosed, and they themselves refrained from doing so. Nor if such sum (or accumulations of such transfers) were included in an omnibus item on the debit side of the balance sheet and the fact was clearly stated

that it was so included, would an auditor necessarily consider it to be his duty to mention the amount in his report if the directors, acting to the best of their judgment and again in the shareholders' interests, refrained from stating the amount? I think not.

An auditor, if consulting his own wishes only, would like to see in many cases fuller disclosure and more informative accounts; but he is not responsible for the form the accounts take that are submitted to the shareholders. His duty is to report to the members of the company, and if he thinks the accounts are misleading in their presentation—after taking into due consideration the phraseology adopted by the directors in describing how profits or losses have been arrived at, or collective figures stated in the balance sheet—then he should inform the shareholders.

But when profits of a year are supplemented or losses lessened or turned into apparent profits by transfers from contingency provisions that are found to be no longer required—and become in effect, therefore, free reserves—or current revenue charges are debited thereto, then it may be said that different considerations arise and it would require very cogent reasons for the amounts not to be disclosed. But general principles, as I have tried to illustrate, sound and unassailable as they may seem to be, cannot in all conceivable conditions be regarded as sacrosanct, and I would not care to dogmatise on the subject.

Second, I am very doubtful as to the desirability of compelling by legislation all commercial and industrial companies to disclose in every case the amounts transferred from or to the profit and loss account as previously referred to by me. Once compulsion is established by law there can be no exception, whatever the circumstances may be, and it might be that, apart from the transfers themselves, difficulties would arise in the application of the principle such as in writing down of stocks, in provision for doubtful debts, in the valuation of frozen credits or balances, and in many other directions of which Mr. Cash has given illustrations. The directors in their review of assets for balance sheet purposes might have their discretion and their judgment disturbed by that they thought was the full meaning and effect of such legislation, and the caution and discernment they exercise for the permanent good of the company, and therefore of the shareholders, would be affected. Whilst auditors may have their views, directors also have their views, and they may not correspond. The auditors are not the managers or administrators of a company's affairs, the directors are, and appointed by the shareholders for the purpose, to whom they are accountable, and before legislation is contem-

plated of the nature indicated there should at least be a very thorough inquiry and the considered views heard of managing directors and other members of boards of very large and important companies whose businesses are not free from serious hazards and risks which often need anticipatory action. And in such an inquiry, if held, auditors of experience would only be too glad to assist. (Cheers and applause.)

[The following notes were also handed in, but through lack of time the speech could not be delivered.]

MR. H. M. BARTON, F.C.A. (Great Britain) : Mr. Morgan has rendered great service to investors and to the profession by his public advocacy on many occasions of more informative accounts and especially of the need for profit and loss accounts that show, within reasonable limits, the profit-earning capacity of a business. While we all may not agree with everything that Mr. Morgan says, his paper represents a very valuable contribution to the question of the auditor's responsibility in relation to balance sheets and profit and loss accounts and, since it may be quoted as an authoritative document in having been presented to this Congress by a past President of the Incorporated Society, I would like to refer to a few points on which there is some divergence of opinion or in regard to which I think Mr. Morgan's meaning is not entirely clear.

All will agree with Mr. Morgan in his plea that the published accounts of companies must not be misleading, but I fear that some of us do not altogether follow him in his views as to what constitutes a misleading account.

First I feel that, after reading Mr. Morgan's paper, one obtains the impression that he regards the creation or utilisation of secret reserves as affecting the accuracy of the profit and loss account in all cases. I would refer in particular to page 502 of his paper, where he says "It should be borne in mind that a secret reserve can arise only through an understatement of profit and in no other way and it cannot be denied that balance sheets or profit and loss accounts which are affected by secret reserves are untrue to the extent of such reserves." The mesmeric influence of the profit and loss account seems to have deflected Mr. Morgan from a full consideration of that part of the title of his paper which refers to "balance sheets." There are, of course, certain types of secret reserves which affect the balance sheet alone, e.g. an improvement in the value of fixed assets since purchase, the understatement of the market value of investments compared with their stated book value and the existence of a reserve for bad debts in excess of actual requirements due to its proper

creation in the past but no longer required. It might be inferred from Mr. Morgan's paper that he would regard balance sheets that failed to disclose the extent of such reserves as untrue or misleading but I do not think he intended to give this impression.

There is no doubt, however, that Mr. Morgan regards as misleading accounts which do not show the actual extent of those types of secret reserves which in some way affect the profit and loss account. Although he holds this view, yet he suggests that in such cases the auditor would fulfil his duty merely if he qualified his report to the effect that the correctness of the accounts was subject to the non-disclosure of the amount of the reserve. Any such qualification, whilst having the merit of emphasising the existence of the reserve, adds nothing in the way of information to the shareholders and does not make the accounts any more informative, or, according to Mr. Morgan's view, less misleading.

In another instance, on page 508 of his paper, he says—"If a balance sheet does not comply with the five conditions which I have enumerated, it becomes the duty of the auditor to call attention in his report to the shareholders to any omission and to any and every item to which he takes exception. The wording employed should be sufficiently clear and definite to avoid misunderstanding, but it is not part of the auditor's duty actually to rectify any misstatement or omission in the balance sheet, or to express his opinion as to the amount that is involved thereby."

Frankly, this conception of an auditor's duty in cases where accounts are misleading somewhat startles me. I would refer to the well-known cases of the *London & General Bank, Ltd.*, and *Newton v. Birmingham Small Arms Co.*, extracts from the judgments on which are set out on pages 489 and 494 of Mr. Morgan's paper. I regard it as the duty of an auditor to rectify in his report, so far as is reasonably possible, any material misstatement or omission from the balance sheet. I will take a simple illustration of the kind of misstatement I have in mind—say a company that is owed a substantial sum by a debtor with whose ability to pay the auditor is completely dissatisfied, but the directors refuse to make proper provision for the probable loss. Should the amount involved be material in relation to the total resources of the company, I think quite definitely that it would be the auditor's duty to state in his report the extent to which, in his view, the debtors are overstated.

On page 505 of his paper, Mr. Morgan states that in the term "secret reserve" he does not include the making of proper provisions for estimated

losses or expenses not definitely ascertainable. The problem with which the auditor may be faced, however, is at what precise point does a proper provision for some contingency become a secret or free reserve. Clearly, this must depend on the circumstances of each individual case and the auditor cannot escape the responsibility of exercising his individual judgment.

Mr. Morgan commends to our notice the report of the Society of Incorporated Accountants and in particular the recommendation in favour of amending legislation. As we all know, there is considerable difference of opinion as to whether the time is at present ripe for fresh legislation, having regard to the short time that has elapsed since the introduction of the Companies Act, 1929. Irrespective, however, of any amendment in the law as to the form and contents of accounts, it does seem to me that the auditor already has adequate means open to him of dealing with accounts that are, in his opinion, misleading, viz., the medium of his report to the shareholders.

The question of secret reserves is a practical problem with which accountants have to deal day by day, and I would summarise my views on the matter by saying that, where a secret reserve is utilised in relief of losses or to bolster up profits without disclosure of the amount so used, thereby affecting materially the disclosure of the company's current earnings, the accounts should be regarded as misleading; in such cases it is not enough merely to indicate the utilisation of a reserve. Where the creation of a secret reserve is stated without disclosure of the amount, I do not think that the accounts should be regarded as misleading unless the company's earnings are materially affected, in which event the question of disclosure may arise.

Lest I should be thought over critical of Mr. Morgan's admirable paper, I would say that it is only right to bear in mind that he was a witness in the *Royal Mail* case and, as a consequence, his views and conclusions must, quite naturally, be largely influenced by the special circumstances that were brought to light in those proceedings. Confirmation of this is, I think, forthcoming in certain of his proposals in regard to secret reserves and profit and loss accounts, which appear to be directed chiefly to the particular points that arose in the case. Accordingly an explanation is afforded of the difficulty I have experienced in the practical application of some of his proposals to the different types of secret reserves referred to in the opinion of counsel quoted on page 503 of his paper. I will mention, by way of illustration, the understatement of

stock and over-generous provision for depreciation, bad debts and the like. I should have liked Mr. Morgan to give his views on these matters as well.

What is the conclusion of the matter? In my view, it is impossible to lay down a standard of conduct for every case and the solution of these problems, so it seems to me, rests in the exercise of a right judgment on each set of circumstances of each point, and where, in the opinion of the auditor, the accounts submitted to him are misleading in a material particular, he should state his views through the medium of his report to the shareholders with clearness and with courage.

MR. HENRY MORGAN: Mr. Chairman, my Lord President, ladies and gentlemen, let me thank the many speakers for their generous expressions with regard to my paper, and in doing so very briefly ask them not to regard such brevity as the measure of my very great appreciation of what they have said. It would be impossible to do what I should wish, that is, to reply to all the various speakers. Therefore I shall merely refer to some of the principal issues which have been raised in the course of this discussion.

First of all there is the question of amending legislation. Some speakers strongly support that suggestion. Others have evinced equally strong opposition to it. But I would ask the latter if they are satisfied with the present practice in regard to companies' accounts, which is going on as a consequence of the 1929 Act. It must be obvious to anyone who studies the provisions of that Act that its intention and spirit was to ensure greater and reasonable information to shareholders. There are set out in detail provisions as to the form and contents of the balance sheet. Those provisions have been in a great many cases completely nullified by the growth and extension of the subsidiary company principle. We can recall many cases where a very large part of a company's capital, and sometimes amounts equalling or exceeding the whole, have been transferred to subsidiary companies. What is the result? A cloak is drawn right across that part of the shareholders' capital and how it is represented. The inefficient provisions of the Act with regard to subsidiary companies have, in my opinion, made the position worse than what it was before the passage of the Act, because many people read into those provisions some sort of legislative sanction for the ignoring of accountancy principles. This question of the accounts of public companies is a very serious one for our profession, because unless abuses which are obvious are eliminated it must tend to destroy public confidence in

the value of and reliance to be placed on the accounts which we certify. With the law and practice as at present how much can we say is definitely implied by the balance sheet with an auditor's certificate of a company whose capital is largely represented by interests in subsidiaries? Shareholders could be satisfied that there is nothing irregular in connection with the accounts of the holding company, but it does not necessarily follow that there may be nothing in connection with the accounts of the subsidiary companies, which if it had occurred in connection with the holding company, would have been brought to the notice of the shareholders. It does not necessarily follow that the true and correct position of the holding company is shown by its balance sheet. Of course, all legal requirements will have been complied with, but the position of the company must be dependent to a very large extent on the value of the interests in subsidiary companies and with regard to subsidiary companies the required information is of so vague a character that there can frequently be little reliance upon the correctness of the value stated. We have got to bear in mind that with regard to subsidiary companies and their results the auditor has no direct concern; that, by the Act, is the concern of the directors, by whom the statement regarding their profits and losses has to be signed.

Then with regard to the profit and loss account, it does not necessarily follow that the true result is shown by such account. We know that the most frequent method, regarded as compliance with the Act, is to bring in the profits of subsidiary companies only to the extent of dividends declared. Those dividends may be paid out of profits of the year, or they may be paid out of profits of other years; or again, there may be big profits remaining undistributed in the subsidiary companies. Therefore, it is always a matter of doubt, where subsidiaries exist, as to whether a profit and loss account can be relied upon as showing the actual result of the company's operations for any year. Is it surprising that the question is sometimes asked, "What is the value of a balance sheet in view of the present law?" In my opinion it is vitally important that members of the accountancy profession should use their efforts to get the unsatisfactory provisions of the law amended.

Touching upon the question of secret reserves, Mr. Kemp in his observations has given us a hypothetical case where a balance sheet drawn up with the definite intention of concealing information affecting the position of the company had resulted in material benefit to shareholders. History is full of cases where great success has followed as a result of

actions which could not be justified on any other ground than the success which has attended them. It is a promulgation of the doctrine that the end justifies the means. I wish to say that I for one do not subscribe to it and in my opinion it would be a dangerous doctrine for accountants to follow. Mr. Kemp also suggested that the extent to which accountancy principles might be departed from is a question of degree. Again I do not agree with his view, because I believe that where a question is involved as to what is right and proper, any consideration as to degree should not enter into it.

With regard to the profit and loss account, some speakers have indicated their objection to extending the auditor's report to that account, as I recommend. I can understand one of the chief reasons which may underlie that objection. I can give it in a word or two—secret reserves. As regards the balance sheet a secret reserve so long as it exists can always be regarded as consistent with the view that an auditor is justified in certifying a balance sheet as true and correct even though the actual position may be considerably better. That doctrine, if accepted, can always be justified so long as the reserves exist and it is not affected whatever fluctuations in such reserve might take place. When you come to the profit and loss account, however, it operates quite differently. The result disclosed by the profit and loss account would always be at least as good as the actual, so long as the secret or internal reserve is increasing. Once you have a fluctuation in a downward direction, then that doctrine does not apply, because the result disclosed by the profit and loss account is better than what it actually is. Thus there arises a special difficulty with regard to the profit and loss account so long as it is affected by any secret reserve. The difficulty in practice is sometimes met by "indicating" that accountancy principles have been departed from either by some more or less vague phraseology in the wording of the balance sheet or the profit and loss account; or sometimes by some innocent-looking qualification in the auditor's certificate. Shareholders and the public frequently do not realise the significance to be attached to any qualification in the report of the auditor. Therefore I maintain that it should always be made quite clear in every case if sound principles have not been adhered to.

I was very much interested in the remarks made by Mr. Cash. He indicated cases where difficulty might occur in regard to dealing with certain matters which must arise in connection with accounts. It appears to me that they relate to "provisions" which it is necessary and proper

to make and are distinguishable from what I have referred to as "reserves." In my paper I endeavour to point out clearly the distinction between "reserves" and "provisions" which have to be taken into account in arriving at the result shown by the profit and loss account. Those provisions, in my opinion, it would not as a general rule be necessary to state separately, but I do urge that anything in the nature of a free reserve which affects the result shown by the profit and loss account should be disclosed both at the time of its creation and at the time of its utilisation.

Mr. Kemp put a question to me with regard to the disclosure of the amount by which an auditor might consider the profit and loss account was over or under stated. It is not the duty of the auditor to rectify accounts. I stated in my paper that if an auditor has to qualify his certificate in regard to the balance sheet, he should make it clear in what respect he takes exception to it, but it is not his duty to state the amount involved. In my opinion exactly the same principle would apply to the profit and loss account.

Mr. Lindsay Fisher referred to my observations upon the duties of auditors and amending legislation in relation thereto. Surely there is nothing very drastic, certainly not opposed to the interests of our profession, if the duties of the auditor regarding the profit and loss account were defined as in the case of the balance sheet. I have stated that to extend his report to the profit and loss account is no greater responsibility than in the case of the balance sheet, and if it were so provided by law it would remove doubt which at present exists.

Much has been said this morning about the directors' point of view, but there is also the shareholders' point of view. Auditors have been described as the "watchdogs of the shareholders" and we have got to form our own opinions. We have to consider the views of the directors, but if there were ground for the view that auditors are unduly swayed by the opinions of directors rather than expressing their own independent opinion as to the correctness and truth of the balance sheet and accounts, it can only tend to affect the confidence of shareholders and the public.

Some little alarm seems to me to exist regarding any extension of the responsibility of auditors. I for one should not fear extension of responsibility provided always, as I said before, that the responsibility placed upon us is fair and reasonable and that it is clearly defined both as to extent and nature.

I will conclude my observations by saying that in my opinion the

fulfilment of the destiny of the accountancy profession is not to be sought in the avoidance of responsibility. (Cheers and applause.)

THE CHAIRMAN : I have allotted half a minute to Dr. Voss and half a minute to Colonel Montgomery to reply to the speeches.

DR. VOSS : Only two words. I thank you very much, Sir, for giving me the opportunity to address this meeting, and especially I thank those speakers who have referred so kindly to my paper. I would have been surprised if the discussion had not disclosed a great difference of opinion. After all, discussions would not be interesting if we all had the same opinion. But there is one point on which I think we are all agreed, that we are willing to accept a fair and reasonable degree of responsibility commensurate with the standing of our profession. I may conclude by expressing the hope that this discussion will prove of value to the members of our profession to which we are so devoted.

I thank you.

COLONEL MONTGOMERY : Mr. Chairman, I think I must ask our Lord President to exercise his high prerogative and continue these proceedings for another week, otherwise I shall have to ask my friend Mr. Van Dien to withdraw one of his remarks. For many years, commencing with the First International Congress—and the matter was very fully dealt with in Amsterdam—we thought that we had built up a very good code of professional honour. He now tells us that we have practically no duty whatever to shareholders. (Laughter.)

THE CHAIRMAN : My Lord President, ladies and gentlemen, from the discussion to which we have listened with interest it is evident that there exists a measure of disagreement. This does not surprise me in the very least. The world would be very dull indeed if all men of intelligence agreed on all points. What has impressed me, however, more than anything else is the fact of our unanimity in ideals and objectives, before which the importance of agreement as to methods of attaining them sink into significance. I am certain that if and as long as we retain our determination to serve as effectively as we possibly can our fellow men in all countries, and in all humility and with singleness of purpose explore every avenue that may lead to this goal, our efforts will not be in vain.

Before I ask Mr. Colville to give out one or two notices there remains for me the duty and pleasure of according to Mr. Morgan, Dr. Voss, and Colonel Montgomery the hearty thanks of this meeting. (Applause.)



[Photo by Elliott & Fry]
MR. E. CASSLETON ELLIOTT, F.S.A.A.

FRIDAY, 21st JULY, 1933

Afternoon Session

CHAIRMAN: Mr. E. CASSLETON ELLIOTT, F.S.A.A. (*President of the Society of Incorporated Accountants and Auditors*).

HONORARY } MONS. S. WOJCIECHOWSKI (Poland).

CHAIRMEN } M. LE DOYEN N. BUTCULESCU (Roumania).

PAPERS

“Depreciation and Obsolescence—Methods of Dealing with these Matters including Annual Appraisals”

MR. H. G. HOWITT, D.S.O., M.C., F.C.A.

MR. A. S. FEDDE, C.P.A. (*New York City*)

DEPRECIATION AND OBSOLESCENCE

METHODS OF DEALING WITH THESE MATTERS
INCLUDING ANNUAL APPRAISALS

BY

H. G. HOWITT, D.S.O., M.C., F.C.A.

INTRODUCTION.

May I, in addressing for the first time an international gathering, seek encouragement towards my task, from the thoughts of one of the most international of my countrymen on the subject allotted to me? It was William Shakespeare who said:—

“ The cloud-capp'd towers, the gorgeous palaces,
The solemn temples, the great globe itself,
Yea, all which it inherit, shall dissolve,
And, like this insubstantial pageant faded,
Leave not a rack behind.”

The Tempest (Act IV. Sc. I.).

It seems to me that such sentiments represent the correct frame of mind in which to approach our problem. Even if we need not normally follow the poet in his call for depreciation of the land on which we live, it would nevertheless be well if there were more general recognition of his views on the inevitability of decay in other forms of material assets—without perhaps going as far as he does in denying to them so poetically even a scrap value.

It is because of the urgent need for such recognition in these days of rapid change, that I should like to direct my remarks more to stressing underlying principles than to dealing exhaustively with the accountancy and actuarial application of them. For the same reason I propose to deal primarily with the ordinary problems met with in commercial practice, and not to attempt to cover the whole field of special undertakings, such as railways and public utilities.

PRELIMINARY CONSIDERATIONS.

Depreciation in its broadest sense, apart altogether from accountancy, is a lessening in value from any cause whatsoever, and in that sense it may, in times of rising values, be non-existent, or even become converted into appreciation.

In the narrower sense, however, as commonly used in commercial and accountancy practice, charges to revenue account for depreciation do not necessarily imply any close relation to alterations in value, but are intended to distribute capital outlay over the effective life of the asset.

It is largely on account of confusion of thought between these two conceptions that much ill-informed criticism is directed in these days against published accounts, especially as of late, in times of falling values. Such criticism fails to recognise the limitations of any single document, e.g. a balance sheet, in viewing an asset from two aspects, namely (*a*) as an historical record of what has in fact been done in the spending and spreading of capital outlay and (*b*) as a guide to its current value, whether for the purposes of immediate realisation, or as an integral part of a continuing business.

If for any reason a review on the lines of (*b*) is required, the problem has then ceased to be one of accountancy depreciation, and has moved into the quite separate realm of appraisal. Value assessed on such a basis is a function of earning capacity, with replacement cost as an upper, and scrap value as a lower limit.

Accountancy depreciation then, is the measure of the exhaustion of effective life, due either to use or to obsolescence. Use refers mainly to wear and tear, though in the case of certain assets it may include exhaustion of material available, or of the time limit of ownership. Obsolescence is normally brought about by the march of invention, and the demands of efficiency. In so far as the estimated periods of effective life under these causes of depreciation may differ from each other, the shortest should be adopted as the period over which the depreciation calculations are to provide for the capital outlay.

Appraisals are of use, for such calculations, only for purposes of estimating, and from time to time revising, the estimates of effective

life, and for estimating the scrap value which will remain when that effective life has run. In these days the factor of obsolescence is frequently more important and its estimation more in need of constant revision than is that of wear and tear. It requires, when it can be foreseen, to be provided for during the period of accrual, i.e. as a matter of true "obsolescence" and not as a matter of "obsolescence." Sometimes, of course, it arrives suddenly, and may be too substantial in amount to be met out of revenue.

It remains to consider what is meant by effective life, a period which is naturally affected by questions of upkeep and renewal. Charges for upkeep, if properly so classified, present no accountancy difficulties, provided the annual expenditure thereon is adequate to maintain the assets as carefully as was contemplated when the effective life was estimated. Even the renewal of a complete unit, the subject of depreciation, produces no accountancy difficulty in this respect, for it represents new capital outlay requiring to be dealt with separately as such.

A renewal, however, of a part of an asset, the effect of which is to extend the life of the whole, has a direct bearing on the proper calculation of depreciation of the whole. It may be that a unit has several component parts, each calling for renewal at different times before the whole is scrapped. In such cases the renewal expenditure, designed as it is to arrest depreciation, is not a revenue charge in the period of its outlay, but should in the necessary calculations be added to original capital cost less estimated scrap value, and the whole provided for as depreciation over the estimated effective life as extended by such renewals.

The part of an asset renewed may be better and more costly than the part it replaces. So far as this excess cost represents expenditure necessarily incurred to keep abreast of the times, without increasing earning capacity, it is preferable that it should be charged to revenue. If, however, it represents betterment in the sense of being a definite improvement, adding to earning capacity or effective life of the whole, it may be capitalised, and the depreciation chargeable on the whole will need to be amended accordingly.

Effective life, then, is the period beyond which it does not pay

either to keep the asset in use by repair, or to renew a part of it. When effective life has run, the whole unit must be replaced. The problem of depreciation is, therefore, to provide for that eventual loss as it accrues, instead of as it is made good.

METHODS.

The choice of method for calculating depreciation in any particular case is influenced by many considerations. There is firstly the decision, as to whether depreciation should be limited strictly to writing off past cost, or whether its function should be to provide replacement. If choice falls on the former aim, there is secondly the decision as to the manner of spreading that cost, in which case a variety of methods is available. Before discussing them in detail, however, it may be advisable to consider the relationship of this choice of method to the allied questions of renewals and repairs.

Renewals of parts of a unit have already been discussed in their bearing on effective life, and their method of treatment from this point of view has been indicated. If, however, renewals, whether of parts of a unit or of the whole, are of constant recurrence, though irregular in amount and interval, they may represent the major consideration in the whole problem. In these cases their cost, so far as not resulting in betterment, may conveniently be charged to a reserve for renewals account, which account is then fed yearly from revenue, by an amount calculated by the engineers, to represent the annual requirement under this head. The method is accordingly in common use for such permanent enterprises as railway companies, and is a factor in what is called the double account system—a system which regards original capital and additions as sunk for all time, and deals in a separate balance sheet with the more liquid position, including the reserves for renewals.

In regard to repairs, it is sometimes urged that if this item of expense is likely to vary over the asset's life, e.g. to be heavier in its later years, a method of depreciation should be selected, which will, in effect, spread the total charge under these two heads equally over the period. This may appear attractive as a practical proposition though really it represents a confusion of issues. If the object of

such a proposition be to spread the total depreciation plus repairs, in ratio to the value of the service to be obtained from the asset over the different years of its life, it may well be that a curve of a very specialised nature would need to be adopted—a curve which might rise to a peak after a short period of running-in, and which, after remaining fairly constant at that level for a time, might rapidly fall.

An engineering basis of this nature might need to have regard to other expenses as well, and unless such an approach be required, it seems preferable to deal with depreciation separately, in the manner most appropriate to the asset, and to the business concerned. Repairs, and other running expenses applicable to assets of different ages, will then tend to average themselves in total for the business as a whole.

Having now touched on specialised cases, it remains to consider the normal methods of depreciation, where all current repairs are charged to revenue, and where renewals, when they do arise, are renewals of whole units charged to capital. In such cases the methods in common use are as follows :—

(a) To spread the charge so that a gradually decreasing share falls on the later years. The method by which this is accomplished is to calculate depreciation as a fixed percentage on the reducing balance of the asset account.

(b) To introduce the consideration of interest, the effect of which is to make a gradually increasing charge fall on the later years. There are the following two methods which produce this result :—

(i) The sinking fund method, under which a constant annual sum is provided for depreciation, and in addition a charge is made for interest on the sums so set aside and used in the business, or if such sums are separately invested, the interest earned thereon is itself added to the provisions.

(ii) The annuity method under which interest is charged on and added to the depreciated residue of the asset's cost, and the accumulating total is then written off equally over the period.

(c) To write off cost *pro rata* over the life, or over the use of the asset. This is known as the straight line method.

Examples of the working of these methods are given in Tables 1-3.

It is not proposed to discuss them at length, but the following notes on each method may sufficiently cover the ground.

(a) A percentage charge on the reducing balance is the method most frequently used in England, in cases where the period of life is not so short as to throw an undue burden on to earlier years. Whatever the cause may have been for its adoption, the retention of this method is no doubt encouraged by the fact that, except as regards ships, where the straight line principles are followed, the wear and tear allowances for income-tax purposes are normally computed on this basis. It may here be mentioned that in times of financial stress and high taxation, the income-tax rate tends to become the maximum rate adopted in accounts as published, and a fair allowance for tax purposes carries, therefore, a much wider implication than it does if viewed merely as a means towards the fair assessment of tax payments. One would like to think that the converse was also true, namely that published accounts should provide as a minimum the income-tax allowance, but unfortunately this is not always the case.

The advantages of this method may be said to be :—

(i) It is conservative in that it places a heavier charge on the earlier years, thereby recognising in part the heavy loss in value, judged by considerations of resale, that normally takes place immediately a new asset is put into use.

(ii) It graduates the charge, in that however long the assets remain in effective use, there is always some annual charge to be met ; there is no sudden relief to revenue through their having become fully depreciated on the books.

The main disadvantages are :—

(i) Assets tend to be dealt with in groups with no clear record as to the book value at any date of individual items ; if so dealt with, any satisfactory summary of depreciation provisions on existing assets for balance sheet purposes, becomes difficult or even impossible. The effect, unless plant registers are carefully maintained, may be to leave in capital some portion of an asset's cost long after it has been scrapped, or, alternatively, to rob the reserve, which is being accumulated in respect of existing assets.

(ii) There is not sufficient recognition of the slowness of this method in writing an item off, with the result that too low a rate is often adopted.

To emphasise the last point, it may suffice to mention that at normal rates (up to say 10 per cent.) over the periods in which depreciation on original cost would have written off the whole asset (e.g. in ten years at 10 per cent. or in 20 years at 5 per cent. &c.) the amount written off on the reducing balance method is only about 65 per cent. of that original cost. In order to leave a residual scrap value of say 10 per cent. of original cost, it is necessary that the depreciation calculations shall run for more than double the time that would have been required on the straight line basis—or alternatively, a rate more than double the straight line rate is required on the reducing balance basis, to reduce to that scrap value in the same period. If a lower scrap value than 10 per cent. on original cost be assumed—and with modern complex machines, such value tends to diminish in proportion—this difference in result between the two methods becomes increasingly accentuated. In Table 4 are shown the percentages left on the asset account at different rates of depreciation over an extended period.

(b) (i) Depreciation on the sinking fund basis is no doubt in certain respects more scientific, in that it takes into account the effects of interest on the fund which is being, or should be, accumulated against the renewal of the asset. It follows in this respect the principles on which sinking funds for the redemption of debentures are calculated, and it may here be pointed out that in so far as debenture moneys are applied in purchasing specific assets, and in so far as the life of those assets is estimated to coincide with the term of the debentures, the provisions for redemption and depreciation are identical in amount, though widely different in nature. In so far as both are provided concurrently, not only will the original cost of the assets have been amortised out of revenue, thereby keeping the proprietor's capital intact, but a further fund will also have been provided, additional to proprietor's capital, enabling the assets, if need be, to be replaced to that extent, free of debt. Provided, therefore, the debenture redemption period is not greater

than the life of the asset, the debenture sinking fund alone will provide adequate depreciation, though it will not provide in addition the funds for replacing the asset.

It is, however, seldom in practice that the sinking fund method of depreciation is adopted for commercial purposes in this country—indeed, it must be admitted that it is the exception rather than the rule for a depreciation fund to be separately invested outside the business; a principle which is specially associated with this method of depreciation, although equally applicable to the other methods.

If the fund is separately invested—and strictly the use of the word “fund” should carry that implication—the annual charge for depreciation, as such, is constant; the increasing element in the total provision being found in the income from such outside investment specifically earmarked for the purpose. If, however, the fund is not separately invested, this increasing element must be found from the extra revenue, presumably earned by leaving the fund as additional capital in the business. In the latter alternative, the provision may, during the later years, become a serious embarrassment, and in either alternative, the fact must remain, that this method is not, during the earlier years, as conservative as are the reducing balance, or straight line methods. Leaving theory aside, therefore, it is perhaps well that it is not in more frequent use for commercial purposes.

(b) (ii) The annuity method is subject to the same criticism as is the sinking fund method, so far as concerns prudence; and the more so in that the accumulation of interest under it is an internal book entry, not provided from outside investment. The interest provision in this case has indeed nothing to do with the depreciation reserve, but is based on the theory that a charge should be made for the finance necessary to carry a particular asset. The desirability of such an interest charge for costing or other purposes, is outside the subject of this address, but it may be permissible to mention, that it introduces considerable difficulties in deciding the rate of interest appropriate to each category of asset at different dates or in assuming, somewhat arbitrarily, how each asset has been financed, and whether from borrowed or from proprietor's money. It is sub-

mitted, therefore, that as this interest provision is added annually to the asset account, requiring amortisation through depreciation charges, it introduces an uncertain element into the problem, which is inflationary and undesirable.

As will be seen from Table 3, the net charge to revenue in each year is identical with that arrived at under the sinking fund method as shown in Table 2. It has, however, reached that result, by offending against sound principles in having added interest to the asset account, and then correcting this, by the further error of charging out interest as though it were in fact depreciation.

(c) The straight line method has the advantages of simplicity and certainty of result, and enables plant registers to be more easily kept for individual items, or classes of items. It does not, however, profess to be particularly scientific in the incidence of its spread over the years, for neither it nor the reducing balance method, deal with the factor of the earning capacity of the accumulating funds. Whether or not the depreciation funds are separately invested, this factor of earning capacity is at work, and both these methods therefore, in effect, have provided more than the book value of the asset, during the period over which they are ostensibly writing it off; they have provided working capital for the use of which no separate interest charge has been made. It should further be remembered in considering the straight line method—and this criticism it shares with the sinking fund and annuity methods—that unless associated with some scheme for re-appraising from time to time the residue of the period of effective life, it may cause violent fluctuations in the annual charge, when large blocks of assets become fully depreciated on the books.

Another method of depreciation, which may be regarded as coming under this heading, is one under which it is sought to write off asset costs *pro rata* on the basis of production, e.g. on the number of tons of steel rolled, &c. The underlying principles in such a case are those of the straight line method, using the factor of production rather than that of time. The method has its merits in periods of normal trading, when wear and tear may vary with throughput, but in times of depression it may be found that the annual charge does not adequately

cover depreciation. To meet this possibility such a method will normally provide for a minimum annual charge, and may further be based upon a sliding scale.

In mining companies the same principle may sometimes be applied to the permanent plant, using as a basis the volume of material worked in the period, compared with the volume which remains capable of being won.

I do not intend to choose between the above three categories of method, for each is specially suitable for particular cases. To take extremes, in order to confirm this point, it may be instanced that the reducing balance method would appear specially applicable to such assets as a luxury liner, whose main revenue may be expected in its earlier years, whilst the sinking fund method would appear preferable for certain public utility companies, where it is necessary to spread the charge fairly, taking interest into account, as between succeeding generations of consumers.

The effects of these two methods in their rate of writing off an asset over the years are, as shown in Table 5, exactly opposite to each other, and this fact alone as a matter of practical politics, may be taken as an indication that in many cases, where no special considerations arise, rough justice may be done by accepting a mean between the two; such a mean being approximately given by the straight line method.

On grounds of prudence, however, there is much to be said for the method of depreciation on the reducing balance, provided the rate is high enough. In view of current criticism it is perhaps fair to the Income Tax Authorities—subject to the same proviso—to point out that the allowance of the major charge in earlier years, is to the taxpayer's advantage, not only from the point of view of interest on tax payments deferred, but also because in these uncertain days "a bird in the hand is worth two in the bush."

It will be seen from Tables 2 and 3 that under the sinking fund and annuity methods, when interest is taken into account, the effective charge on the business for depreciation over the years is constant, as it would in fact be if the annual provision were paid for an outside redemption policy. It may be worth while to consider

what is the effective charge on the business for depreciation, if in fact interest be calculated on the sums set aside under the straight line and reducing balance methods. Table 6 shows the result and from that table it would appear that :—

- (a) Inasmuch as the sinking fund and the annuity methods produce a level annual charge on the business, they might not inaptly be called “ straight line ” methods.
- (b) The method ordinarily known as the “ straight line ” method is akin to a reducing balance method in that the annual depreciation charge which it imposes on the business gradually declines.
- (c) In the case of the method ordinarily known as the “ reducing balance ” method, there is no charge at all on the business in the later years, but on the contrary, a credit, since interest on the fund exceeds the charge appearing under the head of depreciation.

It is, of course, possible to suggest methods which combine certain of the features of the methods under discussion, so as to avoid some of their disadvantages. For instance, if the reducing balance method be adopted, it is possible to change to the straight line when the asset has been substantially reduced, and thus ensure its being completely written off. Or again, even if an asset has become fully depreciated by the straight line or sinking fund methods, and is still in use, depreciation charges may nevertheless continue, in order to reflect the value of the service and to minimise fluctuations in the annual accounts and costings. A surplus depreciation provision may thus accumulate, which will represent an invaluable reserve enabling a broader view to be taken in future decisions as to choice of method, e.g. the straight line method may be adopted with more assurance, if a fund exists to take care of the higher depreciation charges which otherwise in the earlier years it might be thought advisable to provide by the adoption of the reducing balance method.

Whichever method is adopted, it is helpful towards a clear presentation of the balance sheet, that the amount of the accumulated depreciation reserve should be separately stated. Whether so sepa-

rately stated as a liability or as a deduction from the appropriate assets, it is then available for comparison with the book value of those assets, and with the liquid funds available for their replacement. Such presentation of accounts, however, pre-supposes that plant registers or other records have been kept, to ensure that the original cost of assets as sold is eliminated from the gross book value, and that the depreciation reserve as stated is therefore applicable against assets which still exist.

POLICIES.

Having decided which of the above methods shall be adopted in any given case, it remains to decide further what is the capital sum which is to be written off or accumulated. There are two main policies from which selection may be made in this regard : —

- (a) To write off the original cost of the asset, whatever that cost may have been—a policy consistent with a strict definition of “ depreciation.”
- (b) To create a fund large enough to replace that asset at the end of its effective life, whatever its replacement cost may then be.

The first of these policies assumes that the only responsibility of accounts is to keep intact the cash equivalent of the proprietor's original capital, requiring increased replacement costs of comparable assets to be found if need be, out of further capital contributions, or undistributed earned surplus. The second assumes that such increased requirements should be provided for as part of normal trading in order to keep intact, not only original capital, but the assets employed in their material form, or in the form of comparable substitutes. In times of decreasing costs, funds will accumulate under either policy, and will be available as working capital freed from original requirements. It is clear that if the second policy is to be carried to its logical conclusion, an addition based on current costs to each year's charge should be made in times of rising prices, in order to bring previous contributions to the fund into line with what they would have been, had costs then been at the higher level subsequently ruling. It is doubtful whether in practice cal-

culations are ever made on so meticulous a basis, and it would seem sufficient, and more practicable, if this policy be adopted, that such variations on past contributions, should be met by general appropriations of revenue from time to time.

The need to have regard to replacement cost is more in evidence in days of changing values such as those of recent years, than in more normal times. There is, however, a limit to the extent to which increasing capital costs, whether due to world conditions or currency depreciation, can be provided out of revenue.

Conversely, in times of falling prices, companies with old capital assets are penalised in comparison with those embarking upon new construction. In such cases there is again a limit, beyond which current trading cannot hope to provide adequately for depreciation on old, and perhaps inefficient, or non-productive plant. Revenue capabilities may have become so hopelessly out of line with the capital account that nothing short of a writing-down of capital values, with its resultant lessening of the annual charge for depreciation, can meet the case.

Depreciation allowances for tax purposes in this country can, however, only be calculated on the original cost of the asset, and cannot without altering the basic principles of tax computation, take cognisance of current values and replacement costs. An anomaly perhaps exists in the case of obsolescence, in that whilst the allowance is made in respect of original cost not already allowed as depreciation, it is also limited in amount (after adding such depreciation) to the replacement cost of the asset actually replaced.

American income-tax law is, apparently, different in that it allows as a deduction from gross income an item called depreciation, defined as comprising reasonable allowance for the exhaustion and wear and tear of property used in the business, including a reasonable allowance for obsolescence. This in effect represents a double advantage to the American taxpayer, for not only does he obtain the allowance irrespective of replacement, but he obtains it as the obsolescence accrues. In so far, therefore, as accounting practice tends to follow income-tax procedure, the American tax laws encourage the more prudent and correct policy.

There is a third policy, under which fixed assets of a wasting nature, e.g. mines, are not depreciated at all, on the theory that the money was advanced for a special venture, and that admittedly the yearly revenue includes an element of return of capital. As, however, such a policy is obviously outside our subject, there seems no point in pursuing it further.

OBJECTS.

Whichever of the above-mentioned methods is selected as the means by which to carry out the particular policy decided upon, the objects of depreciation charges would appear to be mainly two-fold :—

- (a) To enable a correct record to be kept of what is happening to the proprietor's capital, so far as sunk in depreciating assets, and to show him a correct statement of yearly revenue. These are the functions of the annual accounts.
- (b) To maintain a correct costing record as a guide to the selling departments of his business.

It does not necessarily follow that the depreciation charge made for the annual accounts, dependent as we have seen it is on the policy decided upon, is or should be identical with the charge made for costing and quotation purposes.

For costings as a guide to selling policy, the manufacturer has not so much freedom of choice, for he must have regard to the prices of competitors. For instance, if he owns property bought at periods of high prices, he may not be able to provide for its amortisation through costings and still show a profit, and conversely he may be under-quoting if he only amortises the cost of assets bought at knock-out prices.

Quotations based on costings should have regard not only to cost of the assets employed, but also to their replacement cost. In so far as this factor, if material, is not provided for, quotations will be subject to a sudden variation when such assets have to be replaced, and the selling departments will then be disorganised. It is not necessarily sufficient for costings, taking the long view, to regard expenditure on fixed assets as the fair charge to apportion

over the production to which it contributes, without having regard also to changes in values which may have taken place and to which the selling value of that production itself is subject.

In order that manufacturers may know what the correct depreciation charge should be, there is much to be said for the standardisation of costings by trades, such as has already been undertaken in certain instances. It does not, of course, follow, however perfect the costing, that an adequate price can be realised for the product, but in such circumstances competitors are at least quoting with their eyes open. There is no justification in these days for the frame of mind which regards depreciation, whether for costings or for annual accounts, as a mere book entry to be provided only when sufficient profits are available. Indeed, even if no profits are available, depreciation should be charged, and added to the loss.

APPRAISAL.

We have so far been considering how fixed assets should be dealt with in annual accounts as a matter of historical record as to their cost, or prudent provision for their replacement. It remains to consider whether any corrective can be applied to keep the results so arrived at, in line with current values.

A given asset may be capable of appraisal on many bases, all of interest from different points of view, but not all capable of reflection at the same time in the annual balance sheet, e.g. :—

- (a) A scrap value appraisal may in the last resort interest the mortgagee, and an annual review for such a purpose may be desirable.
- (b) Periodical appraisal on the basis of replacement cost may be of use for accurately assessing future capital commitments, or for determining the amount to be covered by insurance. It may also be helpful, as we have seen, for costing purposes as a guide to selling. True replacement appraisal for such purposes may need to be calculated on the cost of an entirely different and modern unit with appropriate deductions, as it would be meaningless to assume the reconstruction of obsolete plant.
- (c) Even on the basis of depreciated original cost appraisal is

sometimes desirable, in order to re-assess the residue of life of a given asset, and so adjust the depreciation reserve to date.

(d) A going concern basis of annual appraisal presents, however, very different problems which must now be considered.

In most cases the margin of variation in any annual re-appraisal of fixed assets on a going concern basis, would be so wide as to render the keeping of annual accounts in respect of ordinary revenue transactions unimportant in comparison, and a waste of time. This margin would arise, not only out of the choice of methods of valuation available, but also out of variations in price level and even changes in the outlook of the valuers.

It would in any case be difficult for the same valuer to make proper allowances for annual variations, since he would be too near to his previous calculations to be enabled easily to remove himself from their influence. In so far as he might report that an increase in value has occurred, there would further be the inclination on the part of shareholders to regard that surplus, even though capitalised, as being in hand, thus encouraging too generous a distribution of liquid resources. Conversely, a decrease in value could not necessarily be found out of revenue.

Uncertainties arise indeed in the annual valuation of floating assets, but here the corrective of more rapid turnover is available. Assets which do not exist for realisation, and whose value is dependent on the long view of their usefulness in production, present a wholly different problem. No review of the accounts of a large industrial business possessing such assets can usefully include an annual valuation of them.

A major difficulty in attempting such a task is that of viewing any fixed asset, once put into use, as a separate entity, and not as an integral part of the whole organisation. The going concern values of fixed assets are more dependent on their surroundings, their management and on the changing state of the trade in which they are engaged, than on their material cost. To attempt, however, to apportion to them annually some share of these intangible benefits or handicaps is a fruitless task. These matters are in the realm of goodwill which, if need be and if it exists, can be separately

assessed, leaving fixed assets still to be treated on the material bases we have been discussing ; if goodwill does not and is not likely to exist, such assets then assume their even more material value of scrap.

Appraisals, then, on a going concern basis, can only view the concern as a whole, and even for this purpose they must have primary regard to earning capacity. In effect, a going concern appraisal can do no more than value each asset at its material worth, and having arrived at a total, ensure that this total is not more than a reasonable capitalisation of the earning capacity of the business as a complete unit. It is for this reason that for prospectus or similar purposes, the valuer usually wishes to collaborate with the accountant in order to obtain information in regard to earnings as a guide to the maximum which his valuation should not exceed. He requires to see that in total these earnings at least cover the rental charges that he considers appropriate to the different categories of asset employed.

He cannot, in the case of an abnormally profitable business, put his valuation as high as a going concern valuation of the whole undertaking on the basis of those profits might justify. Apart, however, from assessing the extent to which an earning capacity valuation is covered by material assets valued on a going concern basis, his report is also of collateral value as a verification of the existence, and as a guide to the condition, of the property.

It may not be out of place to mention here that the auditor's report on past profits for prospectus purposes, should always, if possible, deal with depreciation. If this is impossible, the auditor is none the less under obligation to see that any deduction made from his profit figures in this respect in the body of the prospectus, is reasonably calculated. He must also have regard for such purposes to the new capital structure, which may call for depreciation on asset values different from those adopted in the past.

Having in mind the extent to which a review of past profits is relied on for prospectus purposes as a guide to the value of a business, it may well be that some review, together with a report on the condition of the property, will come to be included as a part of annual

published accounts. Information on such lines would seem to be the most practical way in which to give an indication of current worth.

LAW.

A detailed review of English law, so far as affecting our subject, would not be possible within the limits of this address, and would not be appropriate for an international gathering. All, therefore, that will be attempted is to make a short selection from the material available in so far as it has a bearing on the principles at issue.

Except in the Income Tax Acts which specify that an allowance shall be made to represent "the diminished value by reason of wear and tear during the year," the present English legislature keeps clear of specific reference to the problem of depreciation. It is true that the Companies Act 1929 goes so far as to require that every balance sheet of a company "shall state how the values of the fixed assets have been arrived at," but it does not venture to suggest what a suitable method of valuation should be for this purpose, nor does it even define "fixed assets." In view of the variety of considerations involved, it is perhaps as well that Acts of Parliament should not endeavour to deal exhaustively with such technical subjects.

Case law is not, however, subject to such restrictions, and having regard to the importance of the subject, it is remarkable how seldom the problem has come before the English Courts, particularly in recent years. It is also remarkable how much diversity of opinion exists as to the proper interpretation of the judgments delivered. There exists, indeed, a not uncommon view, that legally depreciation and other losses of fixed capital, need not be made good before distributing the excess of revenue receipts over revenue expenditure.

In considering the legal cases, however, a distinction may be drawn between depreciation of fixed assets incurred in earning profits during an accounting period, and other losses of fixed capital, such as obsolescence and arrears of depreciation. It does not appear that the Courts have ever laid down that the excess of revenue receipts over revenue expenditure, can properly be distributed in

dividend, before providing for wear and tear of fixed assets during the accounting period. In fact, in at least two cases the Court has expressed the contrary view, namely in the executorship case of *Crabtree v. Crabtree* (1912) where it was held that profits were not properly ascertained before providing for wear and tear, and in the case of the *Barrow Haematite Steel Co.* (1902) where the judge drew attention to the popular misconception on this point, arising out of the decision in the case of the *Neuchatel Asphalte Co.* (1889).

Turning to other losses of fixed capital, such as obsolescence and arrears of past depreciation, the legal decisions appear to indicate fairly clearly that such losses may be disregarded in ascertaining distributable profits, the cases of *Verner v. The General Commercial Investment Trust* (1894) and the *Ammonia Soda Company* (1918) being frequently cited in support of this view. It should, however, be observed, as has been stated again and again in the Courts, that each case must be considered on its own merits, and that great care must be exercised in adopting past decisions as a precedent.

It may be noted in passing how much importance the English legal view appears to attach to an accounting period. Accountancy on the other hand is more inclined to regard deficits on revenue account, including shortages in depreciation charges, as losses which retain their revenue nature and require to be made good out of future earnings. It is indeed one of the most fruitful causes of misunderstanding in connection with accounts that they should be expected over short intervals to state true earnings, when so many considerations arising in their preparation—including particularly the subject of depreciation—are at best matters of estimation, for confirmation of which a longer view is required.

AUDIT.

Having now reviewed the problem from different aspects, it may be of interest to consider the duties of the auditor in respect thereto.

He is not, as auditor, concerned as to which of the before-mentioned policies is adopted, provided it is reasonably consistently followed, and, subject to the same proviso, he is not concerned as to which method is adopted in carrying out that policy. He has not

any responsibility for the methods of dealing with depreciation in costings, except so far as to be satisfied that they do not introduce an unreasonable element into the valuation of stock-in-trade or work-in-progress. These are all matters within the discretion of the Board, honestly exercised.

In regard to amount, however, he has certain definite responsibilities, both as affecting the balance sheet and the revenue account. It is noticeable in this respect how much more important the revenue account is now becoming, not only for itself, but as a means of interpreting the balance sheet. For this purpose alone a correct treatment of depreciation is necessary, and the annual amount thereof should be separately stated. The auditor has no power, however, to insist on such separate disclosure, but should use his best endeavours in that direction.

If the auditor is not satisfied that reasonable depreciation has been provided for the year, whether the amount is disclosed or not, he must qualify his report. He must do so if no depreciation has been provided for the year, unless the accounts specifically state that the results shown are before making such a charge. Any such full disclosure on the face of the accounts should, it is submitted, relieve the auditor of the need of repetition in his report.

His duties, subject to any special provisions in the Articles of Association, are limited to watching that the proprietor's capital so far as sunk in fixed assets is being kept intact, or that, if it is not, the facts are made apparent. It is not sufficient, nor necessary, for him in this respect to be satisfied—if, indeed, he can be satisfied—that asset values in the balance sheet are conservatively stated. The revenue results of the year have had the benefit of the use of those assets and a proper charge for depreciation on their balance sheet value as a minimum should be made. If for any reason this is not practicable (e.g. if obsolescence or other capital losses are so large that reconstruction is the only way of dealing with the excess) he must see that the facts are disclosed.

In practice, auditors are often told that assets are being maintained so fully out of revenue that they have not, in fact, suffered any depreciation through wear and tear. This argument cannot be

admitted, for however efficient the maintenance, all fixed assets, with a few exceptions such as land, must sooner or later be scrapped.

Another contention sometimes urged on the same lines, is that replacements are provided out of revenue and that the value of the plant is, therefore, being kept up-to-date. There may be more substance in this contention, for in the long run the chief distinction between replacements and depreciation charges is that they are borne at different dates. The argument should, however, only be allowed provided the facts are made clear, or provided replacements are sufficiently regular to make the maintenance charge an accurate guide to the annual requirements under this head. There should also in such cases be a depreciation reserve in existence sufficient to cover the normal wear and tear accrued to date.

From the purely balance sheet point of view, the auditor's responsibilities in regard to depreciation are in some ways—contrary to public opinion—more limited than they are in regard to the revenue account. He is in no way a valuer, and except in flagrant cases—and then perhaps comment is superfluous—he should not be called upon to express a valuer's opinion. His comments, if given at all, should be limited to facts such as the absence or insufficiency of depreciation in past years, or the failure to write off of capital losses, or of assets no longer capable of effective use.

GENERAL OBSERVATIONS.

Having now outlined the problems involved in our subject, let us look at their application from a wider aspect.

In a sense, depreciation is the most important, as it is the most difficult, of all accountancy considerations, because, so far as it goes, it attempts the correct treatment of fixed asset values. If these assets could be stated with even the same degree of certainty and uniformity as can floating assets, means would be available toward satisfying the present-day demand that balance sheets should give an indication of current values. There must, however, always be the elements of fluctuation due to variations in earning capacity, management and markets which cannot wholly be catered for either by depreciation or by obsolescence charges, and for which

appraisal is, in most cases, an unworkable alternative.

In early days, commercial depreciation of fixed assets was of small relative importance, for capital was largely of a floating nature. Nowadays, on the contrary, the earning of revenue needs in most cases the sinking of much capital in fixed assets, which assets are largely of value only so far as they can continue to earn revenue. This tendency will no doubt become more in evidence as the industrial system becomes increasingly intense, and as invention calls further for the destruction of obsolete equipment. Hence, the special need, during the present lull in business activity, to stress the importance of depreciation, so that when trade revives, accounts shall be prepared, and prices quoted, with due regard to the correct treatment of this item of expenditure.

Not only are capital assets, in total, tending to become less and less fluid, but individual units of equipment are tending at the same time to become a larger proportion of the whole. The sacrifice that must periodically be faced, therefore, has become a major factor in industrial development, and the ability to bear that sacrifice, depends largely on the adequacy, and the availability of the depreciation funds. It is one of the arguments used in favour of large mergers, that the amalgamating concerns should be able to spread this sacrifice, and so more easily keep abreast of the times. Even in their case, however—and certainly in the case of smaller units—policy tends to be subservient to the effect it is known it will have upon the published accounts. The due provision of depreciation from year to year is, therefore, much more important in its effect on the development of the industry of the country, than it is if viewed merely as a factor in the correct statement of those accounts.

In a wider sense it may be said, that with the development of the world and with the rapid transmission of ideas and material, the advantage which the more advanced nations may derive from their initiative, is of shortening duration. It is now comparatively easy for the less skilled—or even the less civilised—to adopt the processes of others, and even to erect their initial plant, freed from some of the defects of those existing in the countries which took the lead. The shortening of this lag in point of time for reaping the

advantages of invention, puts a perpetual drive on the more advanced nations, if they wish to maintain their standard of living, to embark upon more and more improvement, and to scrap existing assets. It is for this reason that early writing off is more important than too meticulous a choice of method.

It may be that in this country we have tended to produce too good an article for the purposes required. There is no particular harm in this in the case of consumables, so long as the demand remains. In regard, however, to the production of capital assets designed for revenue earning purposes, it is becoming increasingly necessary that, in considering the degree of quality and durability to be put into their construction, due allowance should be made for the possibility that they may be obsolete before they are worn out. A margin for safety is, of course, desirable, but in so far as these two factors can be made to coincide, a future charge for obsolescence may be avoided and a business enabled more readily to adapt itself to changing conditions.

In considering the true significance of industrial accounts, we are continually thrown back to the conclusion that having once embarked upon a venture requiring capital outlay, the proprietor has cast his bread upon the waters; thereafter, subject only to scrap values, it is the earning capacity which is all important, not only in itself, but as the only satisfactory indication of capital values. Carrying this thought to its logical conclusion, one can regard fixed assets (except for their scrap value) as representing merely revenue expenditure incurred in advance of operations. One can imagine a balance sheet recording only liabilities, funds and floating assets (including scrap value of fixed assets), the residue of the fixed assets and other unrepresented assets being carried in suspense as a set-off against the share capital and free reserves. The fixed assets thus suspended would be kept as a memorandum account for the sole purpose of assessing the correct sum to be provided annually for their renewal, by whichever method and policy has been agreed upon. This sum would then be accumulated as a depreciation fund, shown as such on the balance sheet, with its relative investment in floating assets.

The above is not suggested seriously as a suitable form of modern balance sheet, though in underlying principles it has something in common with the double account system adopted by railway companies. As an extreme, it at least emphasises the limitations of annual accounts, and is the logical answer to those who clamour for a balance sheet to be from year to year a true statement of current value. It also emphasises the need—too little observed—of keeping a reasonable proportion of the depreciation fund in liquid form, and at a reasonable proportion of the total capital expenditure requiring renewal.

In so far as the depreciation fund is not liquid, the effect is that the fund required against one fixed asset is invested in another fixed asset ; a policy which, if carried to extremes results in over-spending on capital account—one of the most fruitful causes of financial difficulty. The proportion of the fund which as a minimum, should be kept liquid, varies in different businesses, but it is worthy of remark that in those which are subject to changing conditions, the practice of investing the fund in additional manufacturing assets may lead not only to absence of resources when required, but also to the very negation of the fund because at that same time the plant which represents the fund may itself be obsolete.

If the limitations of balance sheets become more universally recognised, it remains to consider what steps in regard to depreciation may be taken to make them, in conjunction with the profit and loss account, more helpful to the average investor as a guide to the progress of his investments. It would appear neither practicable nor desirable to lay down the method or the policy of depreciation which public companies should be required to follow ; for this involves decisions which each should be allowed to work out for itself, and to suit its own case. It would, however, appear reasonable that any such company should be required to declare the policy it is adopting and the method by which it proposes to make that policy effective. It should also be required to show annually the amount of depreciation charged to carry that policy into effect, and if it changes its principles in this respect to any material extent, it should let that change be known.

CONCLUSIONS.

In order to be as definite and constructive as possible, I will conclude by endeavouring to summarise some of the points which seem to have emerged.

Depreciation is as much a charge in the year's accounts as is any other item of expenditure, the cash payment in respect of which is more closely related to the period in question. It is not an appropriation to be provided only when profits are available.

The difficulty of its treatment involves the central problem of modern accountancy, namely the spreading of expenditure—or of income—fairly over a period of time.

In spreading an asset's cost over its effective life, there are other factors, besides that of time, to be considered, e.g. the curves of usefulness and cost of upkeep, interest and residual value. Obsolescence too, is a vital factor requiring the original estimates of effective life continuously to be revised.

Certain assets can be so maintained that it may be said they do not physically depreciate. In such case the provision for depreciation—though none the less necessary—is in effect a provision for obsolescence.

Effective life of a whole unit may be extended by the renewal of parts thereof. In some cases the question of renewals is the major consideration in the whole problem, which then requires to be dealt with from that point of view.

There are also questions of policy involving the desirability or otherwise of providing out of revenue for replacement at a different cost, whether that difference be due to modern improvements, changing price levels, or to the abnormal price of the original purchase.

In these uncertain days there is more to be said for a broad and prudent policy than for one limited to the exact writing off of past expenditure in a pre-determined way.

Having decided on the policy, the desired object may be attained by a variety of methods, of which the reducing

balance, the straight line and the sinking fund (or the annuity) methods are the orthodox examples.

Each has its special characteristics, to be considered on their merits when selecting the method most suitable for a particular case. Methods can be devised to combine the advantages of each.

Other considerations being equal, favourable regard should be given to the method which accumulates depreciation as early as is reasonably possible. A reasonable portion of the provision to date should be kept liquid.

In all these decisions the undesirability of violent fluctuations both in annual accounts and in costings should be borne in mind. Quotations based on costings should have regard to replacement costs.

Income-tax allowances for depreciation have a deep effect on the economic development of a business or an industry, apart altogether from their primary purpose of fairly assessing tax payments.

Depreciation, as commercially understood, does not seek to leave the residue of expenditure at any moment of time as a true indication of the value of fixed assets.

Appraisals for such a purpose must, when required, be specifically made. They have certain definite uses in specific circumstances, but they are not practicable as an annual review of variation in value.

An auditor is not a valuer and, except in special cases, is under no obligation to comment on fixed asset values. He has, however, a very real responsibility in regard to the provision of depreciation for the period under audit. He must see not only that it is reasonably adequate, but that, if calculated on bases which vary substantially as between different accounting periods, the facts are sufficiently disclosed.

English law has recognised an accountancy distinction between fixed and floating assets. It has not, however, given any very clear indication as to the rules governing the treatment of assets in the former category and is inclined to leave to each

company a wide discretion within the four corners of its own regulations.

With capital values changing as violently as in recent years, there is apt to arise at times a feeling that the normal relationship of revenue to capital is out of joint ; that revenue cannot be expected to provide for capital losses and that a careful calculation of depreciation charges has therefore lost any present-day usefulness. Nevertheless, however clear it may be in extreme cases that nothing short of capital reduction will meet the situation, it cannot be too clearly remembered that the distinction between depreciation and maintenance is mainly a matter of date of provision. Depreciation is a very real operating expense and needs providing for just as much—perhaps even more—in bad times as in good.

Apart from dealing broadly with the accountancy aspect of the subject, I have endeavoured to touch on underlying principles. I have done so because I feel that if accountancy is not so founded, it will not adequately be playing its part towards the solution of the industrial problems of the day.

Finally, I have endeavoured to express views which I hope may be common ground to the profession. If such views in regard to depreciation can be accepted, annual accounts, with all their limitations should, in this important aspect, at least be capable of correct interpretation. My remarks have been directed towards that end.

TABLE I

REDUCING BALANCE METHOD

		Units
Total cost of asset	.. .. .	100,000
Residual value	.. .. .	5,000
Amount to be amortised	.. .. .	<u>95,000</u>

		Amortisation at 5% per annum.		Amortisation at 13.911% per annum.	
		Annual provision	Balance of asset account	Annual provision	Balance of asset account
Year 1	..	5,000	95,000	13,911	86,089
2	..	4,750	90,250	11,976	74,113
3	..	4,512	85,738	10,310	63,803
4	..	4,287	81,451	8,876	54,927
5	..	4,073	77,378	7,641	47,286
6	..	3,869	73,509	6,578	40,708
7	..	3,675	69,834	5,663	35,045
8	..	3,492	66,342	4,875	30,170
9	..	3,317	63,025	4,197	25,973
10	..	3,151	59,874	3,613	22,360
11	..	2,994	56,880	3,110	19,250
12	..	2,844	54,036	2,678	16,572
13	..	2,702	51,334	2,305	14,267
14	..	2,567	48,767	1,985	12,282
15	..	2,438	46,329	1,708	10,574
16	..	2,316	44,013	1,471	9,103
17	..	2,201	41,812	1,266	7,837
18	..	2,091	39,721	1,090	6,747
19	..	1,986	37,735	939	5,808
20	..	1,887	35,848	808	5,000
		<u>64,152</u>		<u>95,000</u>	

Notes :—

- (1) A rate of 5 per cent. which on the straight line method would write the asset off in 20 years has, on the above method, written off less than 65 per cent. thereof.
- (2) In order to leave at the end of 20 years a residual value of 5 per cent. of the cost of the asset, a depreciation rate of nearly 14 per cent. is required.
- (3) For comparison purposes it may be noted in this and in the following tables that on the straight line method the annual provision would be 4,750 units.

TABLE 2

SINKING FUND METHOD

If C units = Original Cost of Asset,

R units = Residual Value,

A units = Amount of an annuity of 1 unit for 20 years, at 4 per cent.,

Then fixed annual provision to Sinking Fund,

$$= \frac{C - R}{A} \text{ units.}$$

	Fixed annual provision	Interest at 4% on total of fund.	Total annual provision	Total deprecia- tion fund.	Asset at cost less depreciat'n fund.
Year 1 ..	3,190	—	3,190	3,190	96,810
2 ..	3,190	128	3,318	6,508	93,492
3 ..	3,190	260	3,450	9,958	90,042
4 ..	3,190	398	3,588	13,546	86,454
5 ..	3,190	542	3,732	17,278	82,722
6 ..	3,190	691	3,881	21,159	78,841
7 ..	3,190	846	4,036	25,195	74,805
8 ..	3,190	1,008	4,198	29,393	70,607
9 ..	3,190	1,176	4,366	33,759	66,241
10 ..	3,190	1,350	4,540	38,299	61,701
11 ..	3,190	1,532	4,722	43,021	56,979
12 ..	3,190	1,721	4,911	47,932	52,068
13 ..	3,190	1,917	5,107	53,039	46,961
14 ..	3,190	2,122	5,312	58,351	41,649
15 ..	3,190	2,334	5,524	63,875	36,125
16 ..	3,190	2,555	5,745	69,620	30,380
17 ..	3,190	2,785	5,975	75,595	24,405
18 ..	3,190	3,024	6,214	81,809	18,191
19 ..	3,190	3,273	6,463	88,272	11,728
20 ..	3,190	3,538	6,728	95,000	5,000
	63,800	31,200	95,000		

Notes :—

- (1) If interest is provided from external investment, the fixed annual provision is, like that under the straight line method, constant in amount though a lesser sum.
- (2) If interest is an internal book entry, the increasing annual charge to revenue corresponds with that arrived at under the annuity method in Table 3.

TABLE 3

ANNUITY METHOD

If p units = present value at 4 per cent. of 1 unit due at the end of 20 years,

And P „ = present value of annuity of 1 unit for 20 years at 4 per cent.,

Then fixed annual provision

$$= \frac{C - R.p}{P} \text{ units}$$

	Fixed annual provision	Interest at 4% on depreciated value of asset (added to asset account)	Net charge to profit and loss account	Total of depreciation fund	Asset at cost less depreciation fund
Year 1 ..	7,190	4,000	3,190	3,190	96,810
2 ..	7,190	3,872	3,318	6,508	93,492
3 ..	7,190	3,740	3,450	9,958	90,042
4 ..	7,190	3,602	3,588	13,546	86,454
5 ..	7,190	3,458	3,732	17,278	82,722
6 ..	7,190	3,309	3,881	21,159	78,841
7 ..	7,190	3,154	4,036	25,195	74,805
8 ..	7,190	2,992	4,198	29,393	70,607
9 ..	7,190	2,824	4,366	33,759	66,241
10 ..	7,190	2,650	4,540	38,299	61,701
11 ..	7,190	2,468	4,722	43,021	56,979
12 ..	7,190	2,279	4,911	47,932	52,068
13 ..	7,190	2,083	5,107	53,039	46,961
14 ..	7,190	1,878	5,312	58,351	41,649
15 ..	7,190	1,666	5,524	63,875	36,125
16 ..	7,190	1,445	5,745	69,620	30,380
17 ..	7,190	1,215	5,975	75,595	24,405
18 ..	7,190	976	6,214	81,809	18,191
19 ..	7,190	727	6,463	88,272	11,728
20 ..	7,190	462	6,728	95,000	5,000
	143,800	48,800	95,000		

Notes :—

- (1) Including the factor of interest, the fixed annual provision is, like that under the straight line method, constant in amount though a larger sum.
- (2) The interest column is in effect an annual credit to revenue of 4,000 units (4 per cent. on the cost of the asset) less an annual charge corresponding in amount and nature to the interest charges shown in Table 2. under the sinking fund method—hence the fixed annual provision in the two methods differ by the 4,000 units, though their final effects on the asset account are identical.

TABLE 4

PERCENTAGE OF ORIGINAL COST WRITTEN OFF, UNDER REDUCING BALANCE
METHOD, AT EACH YEAR END

Years	5%	6%	7%	8%	9%	10%
1	5.00	6.00	7.00	8.00	9.00	10.00
2	9.75	11.64	13.51	15.36	17.19	19.00
3	14.26	16.94	19.56	22.13	24.64	27.10
4	18.55	21.92	25.19	28.36	31.42	34.39
5	22.62	26.61	30.43	34.09	37.59	40.95
6	26.49	31.01	35.31	39.36	43.21	46.86
7	30.16	35.15	39.84	44.21	48.32	52.17
8	33.66	39.04	44.05	48.67	52.97	56.95
9	36.97	42.70	47.97	52.78	57.20	61.26
10	40.12	46.14	51.61	56.56	61.06	65.13
11	43.12	49.37	55.00	60.03	64.56	68.62
12	45.96	52.41	58.15	63.23	67.75	71.76
13	48.67	55.26	61.08	66.17	70.65	74.58
14	51.23	57.95	63.80	68.87	73.29	77.12
15	53.67	60.47	66.33	71.37	75.70	79.41
16	55.99	62.84	68.69	73.66	77.88	81.47
17	58.18	65.07	70.88	75.77	79.87	83.32
18	60.28	67.16	72.92	77.70	81.68	84.99
19	62.26	69.14	74.81	79.48	83.33	86.49
20	64.15	70.99	76.58	81.12	84.83	87.84
25	72.26	78.71	83.76	87.51	90.53	92.82
30	78.54	84.37	88.70	91.77	94.10	95.76
40	87.15	91.58	94.46	96.42	97.70	98.52

TABLE 5

Graph showing balances left on the asset account at each year end, under each of the methods of depreciation referred to in the foregoing tables.

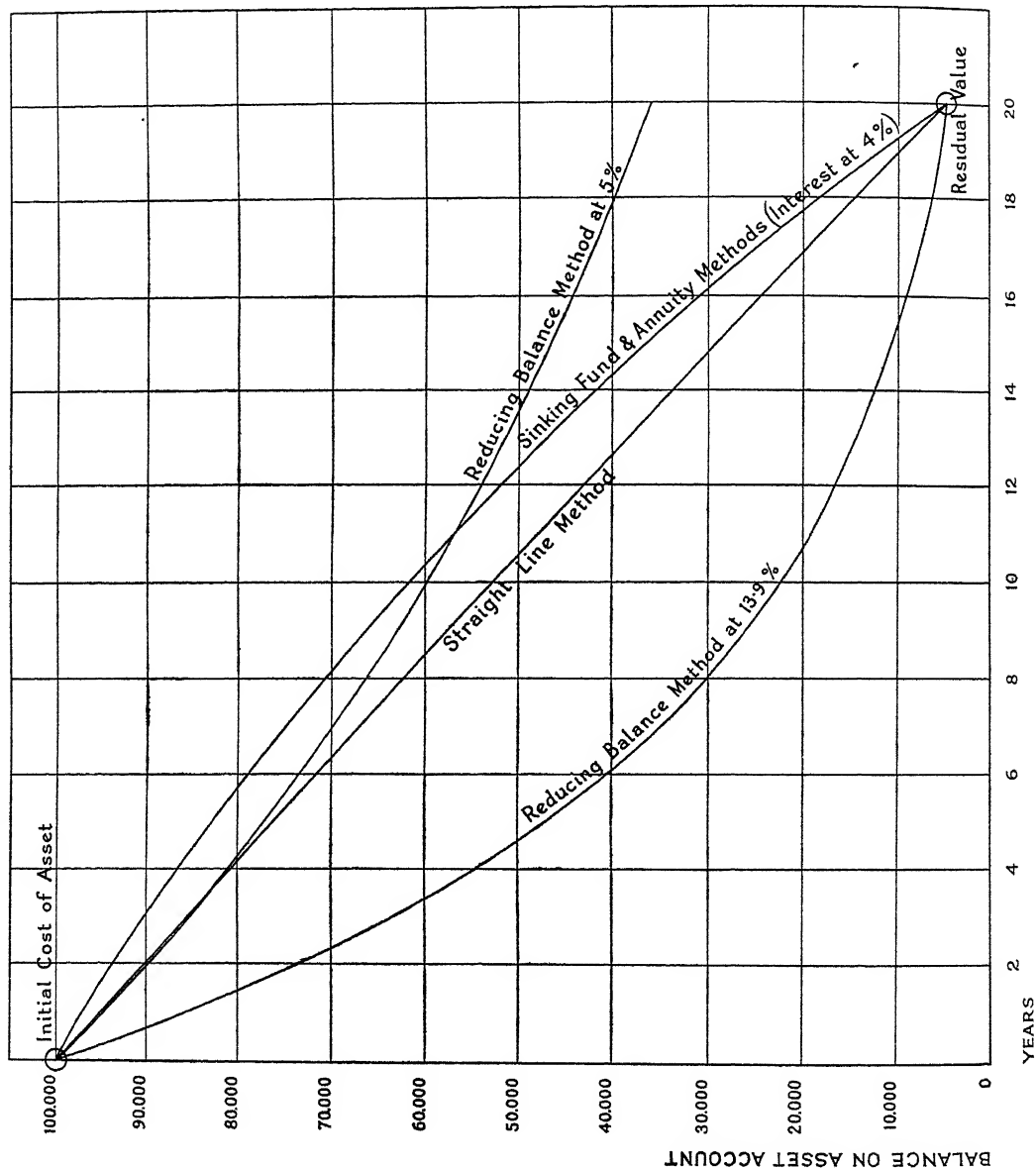


TABLE 6

Table showing the effective depreciation charge against revenue under the foregoing Tables, if credit be taken for the interest deemed to accrue annually at 4 per cent., on the accumulating fund.

Year	Sinking Fund and Annuity Methods	Straight Line Method	Reducing Balance Method at 5%	Balance Method at 13.91%
1	3,190	4,750	5,000	13,911
2	3,190	4,560	4,550	11,420
3	3,190	4,370	4,122	9,275
4	3,190	4,180	3,717	7,428
5	3,190	3,990	3,331	5,838
6	3,190	3,800	2,964	4,469
7	3,190	3,610	2,615	3,291
8	3,190	3,420	2,285	2,277
9	3,190	3,230	1,971	1,404
10	3,190	3,040	1,672	652
11	3,190	2,850	1,389	4
12	3,190	2,660	1,119	— 552
13	3,190	2,470	863	— 1,032
14	3,190	2,280	620	— 1,444
15	3,190	2,090	389	— 1,801
16	3,190	1,900	169	— 2,106
17	3,190	1,710	— 38	— 2,370
18	3,190	1,520	— 236	— 2,596
19	3,190	1,330	— 425	— 2,791
20	3,190	1,140	— 604	— 2,960
Effective depreciation charge	63,800	58,900	35,473	42,317
Interest ..	31,200	36,100	28,679	52,683
Total provision	95,000	95,000	64,152	95,000

Notes.—

(1) The "total provisions" over the period are in effect made up of interest in each case to the extent shown above, but it is only in the sinking fund and annuity methods that they are normally so regarded.

(2) Conversely, if interest were charged on the fund accumulating from the gross sums provided annually as depreciation under the straight line and reducing balance methods, the "total provision" over the period would be substantially more than sufficient to write off the asset account.

DEPRECIATION AND OBSOLESCENCE

METHODS OF DEALING WITH THESE MATTERS INCLUDING ANNUAL APPRAISALS

BY

A. S. FEDDE, C.P.A. (*New York City*)

INTRODUCTION

Although the paper prepared on this subject by Mr. Howitt was in my hands prior to the release of this article, it was not read by me until this had been written in final form. That the premises in the preliminary considerations in the two papers should contain the same thought is therefore some indication that accountants on both sides of the water have the same basic principles in mind, and a recognition that there are fundamentals upon which accountancy practice is based.

GENERAL COMMENTS ON PRINCIPLES AND CONDITIONS

In an accounting sense the term depreciation is considered in a somewhat different light than as mere loss of value, the thought involved being more that of an apportionment of values upon an equitable basis as between capital and expense. Depreciation connected with values pure and simple, with no element of useful life entering into consideration, is applied in the accounting sense mainly to marketable securities and commodities. Depreciation in the sense of its application to fixed tangible assets means the consumption in production processes of a preliminary outlay in such assets as make production possible. As applied to fixed intangible assets, patents, copyrights, franchises, and the like, it means the consumption of the original outlay for such assets through the passage of the time to which their life is limited. Thus we have one class of assets subject to physical depreciation from a combination of use and

passage of time, and another class subject to depreciation from the passage of time alone. Both classes are subject to obsolescence.

This depreciation takes place regardless of rise or fall in values of labour and commodities. The cost of labour and bricks, mortar, lumber, and steel to produce buildings or machinery may rise in a certain year and thus cause buildings and machinery already constructed and in use to rise in value, but such valuation rise has nothing to do with the depreciation charged at the same time to measure the cost of the shrinkage in life span of the fixed assets.

Similarly, the maintenance of efficiency at a relatively even level throughout the life of the asset has no relation to the measurement spoken of, except that a high degree of maintenance may prolong the life of the asset and neglect of maintenance may shorten it. This maintenance of efficiency has been cited by some as proof that depreciation was not then taking place. By close attention to repairs the asset may continue to be as good as new, so far as its functioning is concerned, and the life of the unit may be prolonged beyond that which it would have if such maintenance were not so assiduously applied—but its life, long or short, certainly has an end. The theory that depreciation in such a case does not occur seems to be due to a confusion as to the implication of the term rather than any misunderstanding of the facts. This, no doubt, arises from a mental substitution of current values as measured by efficiency for depreciated values in the accounting sense which is less related to current efficiency of the asset. The latter is the proration of the initial outlay—or prepaid expense as it might be termed—over the estimated life of the asset ; the former is the application of the term depreciation in a non-accounting sense as related to day-to-day or year-to-year money value as measured by the capacity of the asset to function.

In the early life of an asset efficiency may increase, such as in the increased smoothness of operation of a machine, and the maximum of efficiency may be maintained for a considerable part of the asset life. For some time thereafter its efficiency may decline but slightly—a decided decline in efficiency naturally marking the end of its useful life. In an accounting sense one does not consider that appreciation

has taken place with the increased efficiency, nor that depreciation has been suspended or delayed with maintenance of efficiency, nor that depreciation has suddenly taken place at the close of the useful life of the asset.

The term obsolescence applies to complete or partial loss of useful life from causes unconnected with the physical condition of the asset. It has suffered a functional loss though physically it may remain unimpaired.

An asset suffers obsolescence from engineering improvements and new inventions which render it either partially or completely useless. An instance of partial obsolescence is seen in the improvements of engines in steamships which have rendered some types partially, but not entirely obsolete. The sailing vessel, on the other hand, became completely obsolete for most commercial purposes upon the invention of steam for propulsion of ships. Sailing vessels moored in the harbour of New York with bowsprits projecting over South Street some 40 years ago are only a memory.

Other obsolescence may arise through inadequacy or supersession. If we were to consider these two causes of functional loss as being depreciation instead of obsolescence, we would depart from the use of the term depreciation in the accounting sense as to life proration of fixed assets, and begin to apply it in the non-accounting sense as referring to valuation. I prefer, therefore, the term obsolescence to designate the cause of decline in values due to any functional loss as distinguished from physical deterioration.

Inadequacy occurs when an asset is no longer capable of fulfilling the needs of the particular business, though physically it may function as well as previously. When a set of machines is scrapped because larger ones are needed to furnish the desired output they have, so far as that business is concerned, suffered obsolescence because of inadequacy.

Supersession occurs largely through demands or requirements of the public as, for example, demands for highways constructed of concrete, more comfortable apartment houses, more luxurious passenger steamships, underground electric transmission lines, more convenient telephone equipment, and the like. For example,

the telephone transmitter carrying the receiver on a hook, which was in universal use in the United States, has suffered partial obsolescence through the demand of a considerable part of the public for the so-called hand phone embodying both transmitter and receiver in one piece.

Obsolescence through inadequacy and supersession occurs to a greater extent in new territory where the population is increasing. In some relation to the increase in population, capital assets become inadequate ; and other assets such as roads, hotels, civic buildings, and means of transportation become superseded by the necessity of accommodating both a larger population, and popular demands that the facilities be improved simultaneously with their expansion.

In the United States the rate of obsolescence in the past 25 years from the three causes of invention, inadequacy, and supersession has been enormous. Demanding new and improved things had become a habit and led to great extravagance. Beautiful residences, costing in some instances millions of dollars, were purchased and scrapped to make room for shop buildings, huge apartment houses, and great hotels. A building one hundred years old anywhere in New York City—or in the whole country—is a curiosity but not yet an object of interest. Change in type of city dwellings furnishes a notable example of supersession. In some cities whole blocks of private houses were torn down to make way for apartment houses, and in turn apartment houses which are now twenty years old are partly obsolete because of the greater convenience and luxury embodied in newer ones.

For a number of years automobiles were so frequently changed in design that thousands of people made new purchases each year in order to be in possession of cars with the latest improvements. This great demand required constantly enlarged plants and machinery for production. In short, a very considerable part of industry in the United States for many years was concerned with the construction of capital goods on account of inadequacy and to supersede those no longer considered suitable. Idle and abandoned plants scattered over the country bore mute witness to this condition.

The slackening in pace in the construction of capital goods would

be felt more in the United States than in Europe because a larger proportion of the workers in the States are engaged therein. A study of this phase of American industry might throw considerable light on the reasons for present unemployment. It might be found that too great a proportion of the workers was engaged in the production of capital goods with the result of abrupt decline in employment as an accompaniment to decrease in inadequacy and supersession obsolescence.

Where obsolescence has been incurred in total, naturally the asset values which remain require to be charged off except for any residual value. Where it has incurred in part, the asset value remaining requires to be written down in order that operating costs, including depreciation charges based on the remainder, may be comparable in the cost of production with operating costs per unit of production of the improved machine or other asset.

METHODS

Methods of providing for depreciation are enumerated in the paragraphs following ; and with it understood that each method contemplates the writing down of the asset to the residual or salvage value at the end of the useful life, repetition of that statement will be unnecessary.

- (1) The reducing balance method
consists of the application of a uniform rate, calculated on the balance of the asset less depreciation previously written off.
- (2) The straight line method
consists of the application of a rate to the asset value without reduction for depreciation taken.
- (3) The production unit method
provides amounts out of income based on output. In its application to mines, oil wells, &c., it is termed depletion.
- (4) The sinking fund method
is used to set aside equal instalments in a fund, the instalments plus compound interest on the accumulated fund being calculated to reach the amount required over the intended term.

(5) The annuity method

involves the charging of interest on the value of the asset diminished by accumulated depreciation (the contra credit for interest charged being to income), the cost of the asset plus interest thereon, calculated as above, being written down in equal periodical amounts. The charge to operations is for depreciation and use of the asset value, and is therefore made up of depreciation plus interest on the investment.

(6) The maintenance and depreciation method,

as its name indicates, employs a charge contemplated to spread combined repairs and depreciation over the life of the asset in equal annual instalments.

(7) The retirement reserve method

is a flexible means used to accumulate or to appropriate amounts out of income or surplus for the retirement of assets at the end of their useful life.

(8) The appraisal method

involves a valuation of assets, stating cost of reproduction on the basis of current prices less accrued depreciation thereon ; the difference between book values of the assets and appraisal values being charged off as depreciation.

The oldest method is, no doubt, the reducing balance method, which is largely used in Great Britain. Its general use is recognised in regulations under the Finance Act, which will be commented upon later. An advantage appertains to it in its ease of application, under which an item cannot inadvertently be made the subject of additional depreciation once it has been fully depreciated. Another advantage is that smaller amounts are charged for depreciation in the later years of the asset life when maintenance costs would normally be increasing.

These advantages accrue mainly in the case of the smaller industrial concerns, and diminish in proportion as the concern expands, with investment in new and additional plant made from time to time. The expansion would have the effect of spreading the heavy repairs over various periods with fair equality, whereas in the case of a

single small organisation, the charges might be much heavier in certain years than in others. Certain disadvantages are illustrated following mention of the straight line method.

In the United States the straight line method with the depreciation reserve account is in almost universal use in industrial concerns. Small firms that do not keep detailed records of plant items, keep the asset accounts in some form of general classification. To avoid calculating depreciation on assets fully depreciated, an analysis by years of installation is kept, so that additions to an asset account made, say, in the year 1925, and subject to a 10 per cent. rate of depreciation, will be cleared by the depreciation charge in the year 1934 except for a remainder, representing the charge for a portion of a year, to be written off in 1935. The amount shown in the analysis as purchases or installations in the year 1925 will have been balanced by amounts, entered in yearly columns, until the total of such amounts equals that in the asset column.

Some concerns, including many of the larger ones, keep detailed records of principal plant items on which is recorded the depreciation written off and the final disposition of the asset. This record is in some cases in balance with the controlling accounts and in other cases it is a memorandum record.

The straight line method has conservatism in its favour, in that rates may be used that do not appear unduly high, but, being calculated on the original cost, succeed in writing down the assets in a considerably shorter time than the reducing balance method. This is of considerable moment in a country of rapid industrial expansion where invention, inadequacy, and supersession frequently leave substantial amounts to be written off as lost, in spite of high depreciation rates used.

For example, a rate of $4\frac{1}{2}$ per cent. applied on the straight line method to a cost of \$1,000 will reduce it to a scrap value of \$100 in 20 years, whereas, to effect the same reduction in the same time by the reducing balance method, a rate of 10.875 per cent. is required. The $4\frac{1}{2}$ per cent. rate applied on the reducing balance would require approximately 50 years to effect the same reduction ; while at the end of 20 years there would be a balance remaining of \$398, or

39.8 per cent. of cost, which in most cases would be far in excess of scrap value.

Considering conditions, I am strongly of the opinion that the straight line method is much more suitable in the United States than the reducing balance method.

The production unit method is used for calculation of estimated depletion of mines, wells, timber land, and the like. It is also used considerably by public utilities, based on the sale of gas and electric power. This will be further mentioned in the consideration of retirement reserves.

The sinking fund method is used mainly where the purchase of the asset is financed by means of long term indebtedness. However, a provision by means of a sinking fund for retirement of debt may or may not synchronise with actual depreciation, and where a reserve is created for such retirement its relation to actual depreciation should be noted.

Sometimes securities are set aside as investment of depreciation reserve in order that these may be earmarked as capital to avoid being claimed by the Government to be investment of surplus not employed in the business. (Accumulation of surplus not required in the business is subject to a penalty tax under the Federal Revenue Act.) This, however, is not necessarily an application of the sinking fund method but may be an accumulation of depreciation funds under any method. Obviously, the retention of funds in available form, secured from the operation of the depreciation reserve, contributes to the financial strength of an enterprise.

The use of the annuity method is sometimes advocated in cost accounts. It is troublesome to apply in the case of assets having a comparatively short life, and in which there are frequent changes. It can well be used, if desired, in the case of a single asset of long life such as a building or leasehold. The advantages claimed for it are that it equalises cost to the concern owning the asset outright with that of one holding the asset and paying interest on a bonded indebtedness, and indicates the profit or loss after absorbing an interest charge for the amount locked up in a fixed asset. It is similar in theory to the charging of rent into the accounts for a wholly

owned plant. The method is not in extensive use so far as I can ascertain.

The maintenance and depreciation method is very little used, and mainly in those cases involving a single unit or a compact plant. The same result, namely, of spreading maintenance as evenly as may be, is accomplished by accumulating a reserve for extraordinary repairs—as distinguished from current ordinary upkeep—in addition to the reserve for depreciation.

Retirement reserves are accumulated mainly by public utility corporations operating under State systems. Depreciation reserves are used by transportation and communication companies operating in interstate business, the accounts of which are prescribed by the Interstate Commerce Commission.

The operation of retirement reserves is mainly for the purpose of equalising the charge for retirements, the charges being made to "retirement expense" account or to surplus or to both. If upon retirement of plant the credit balance in retirement reserve is insufficient to cover the amount to be written off, the excess of the latter is charged to "property abandoned." This system is based on the theory that the useful life cannot be determined with reasonable accuracy and that therefore flexibility in appropriations is desirable and necessary. It is claimed with good reason that time is not the governing factor in the useful life in the case of public utilities—that invention, inadequacy and supersession are more often the cause for retirement of plant, and that, therefore, the management, in addition to giving consideration to past experience, must look ahead and attempt to forecast retirement by the trend of requirements, making such charges and appropriations as conditions indicate to be desirable. That theory is finding quite general advocacy among power and light companies. However, that which is considered maintenance probably includes replacements which might, under a different system, be considered capital outlay.

The appraisal method will be dealt with in a separate section.

In connection with this discussion of methods, it is of interest to note the totals accumulated as depreciation or depletion by the principal industries in the United States, apart from public utilities

and railroads, as expressed in percentage of reserves to gross plant. The compilation was made by an investment banker for his own use, and is stated to represent between 70 per cent. and 90 per cent. of the total production capacity of the respective industries. These percentages are as follows :—

Steel	30
Oil	43.8
Motor	37.9
Copper	29.1
Electrical	63
Chemical	41.8
Meat packing	41.2
Rubber	39.2
Cement	35.5
Textiles—Cotton	45.8

IMPORTANCE OF DEPRECIATION PROVISION

Charging depreciation of fixed assets on as scientific a basis as possible is necessary in order accurately to measure costs and profits and to maintain the capital of an enterprise from being dissipated by dividend payments in excess of net income. It would seem that the largest and most important single function of public accountants is to distinguish in accounting between capital and income. The measure in this respect is of materiality to stockholders both as it affects their income and the value of their investments, inaccurate valuation of securities at the time of their transfer from one person to another working unmerited gain to one and unwarranted loss to the other. Accuracy of measurement of profits is important also to company officials in order that they may avoid misrepresentation to their stockholders and the public, and that they may avoid liability for distribution of ordinary dividends out of capital.

Certain dividends are of necessity paid out of capital, such as dividends in liquidation, dividends from depletion reserves in the case of mines, &c., and dividends from paid-in surplus, which is permissible in most states. Some companies are organised with the capital divided into two parts, a small amount for stated capital and

a large amount as paid-in surplus with the intention that, as cash becomes available through the operation of the depreciation charge against income, the funds may be withdrawn as dividends out of paid-in surplus. In these cases it is, of course, fully understood by the owners that amounts so returned as dividends out of paid-in surplus are returns of capital.

DISCRETIONARY DEPRECIATION CHARGES

It lies in the discretion of the management of an enterprise or institution to choose their own policy, whether or not to provide for depreciation of donated wasting assets as, for example, a hospital building, a church building, or a club house. By donated, I mean not necessarily by a single donor—it may be by an aggregate of subscriptions or entrance fees or dues, and not represented by issued capital stock.

Where the income accounts are not charged with depreciation they are, of course, overstated by the part of the invested donations or subscriptions which have been consumed in operation. It appears to be the policy in some institutions of this character neither to charge depreciation nor to state that it has been omitted—in fact, to leave the matter of providing funds for replacement to the succeeding generations. It may happen that replacement must be currently made, perhaps because of destruction by fire or from the necessity of moving, as may happen if the property be condemned to provide for street widening or for other municipal requirements; and the replacement then would probably require additional funds for a difference between depreciated value and cost of new construction.

It would seem no more than reasonable in such situations that those having a personal and possibly also a monetary interest, even though represented by membership and not by capital stock, should be apprised in the annual accounts that no provision has been made out of income toward the accumulation of a depreciation or replacement reserve.

REVISION OF ASSET VALUES AND DEPRECIATION CHARGES

In the few years prior to 1930 revaluation of fixed assets was

prevalent among corporations in the United States, assets which had been acquired at a cost less than the then current cost being revalued and set out on the books to include the accretion. This practice came to a sudden end toward the close of the year 1929. In the meantime in many instances the increased values were made the basis for the issue of stock dividends.

The question of depreciation immediately became one of importance. While corporation officials wished the assets carried at the increased figures, many were loath to charge operations with depreciation calculated thereon. Some charged operations with depreciation on cost and charged surplus from appreciation with the depreciation of the increase in book value. In following that practice the asset would become written off by the offset of depreciation reserve, but only the cost would have been recouped from operations, and therefore be represented by cash or other working assets, and the balance of the reserve would be merely surplus from appreciation (which lay in fixed assets) transferred to the depreciation reserve account.

Obviously the act of placing the appreciated values on the books would be the result of a firm belief that cost had permanently advanced and, therefore, the procedure which should logically flow therefrom would be to charge to operations the full amount of depreciation in order to provide a reserve for replacement of the so much more valuable asset. From the legal standpoint, a provision out of profits to the extent of cost would be all that was required, but with the then prevalent belief in the permanence of the current level of costs, it appeared to be the part of prudence to provide for replacement at those levels. Naturally, it seemed inconsistent to capitalise one value in the balance sheet and to provide for replacement through income of another and lower value.

The enhanced valuations have recently been in process of being deflated in the accounts—a sort of blood-letting which is supposed to be good for the patient. Fixed assets are being revalued—much of this was done in 1932—by taking depreciated values at present price levels as the proper ones to carry, and in many cases writing down plants for which no immediate use is in sight to a nominal value.

As part of this process, depreciation reserves are adjusted, depreciation charges are revised, and the net amounts written down are charged off to surplus ; and if further surplus is required to absorb the charge, it is provided by reducing stated or par value of the capital stock. The reports of corporations subsequently show increased profits or decreased losses by reason of decreased charges for depreciation based on the new and lower valuations.

The pré-crash financial operations and the post-crash operations seem to bring to mind a legend connected with the mythical characters bearing the euphonious appellations Jack and Jill. The justification for the present revaluation downward (naturally there must be a justification for Jack and Jill spilling all that water) is that the revision in asset values and capital structure is made through legally possible changes within the corporation, which would unquestionably be proper in a sale to a new corporation, therefore a reorganisation has in effect taken place without the expense involved in a formal reorganisation. The shrinkage in value has taken place, and it is argued that the loss has been sustained and is being recognised by taking it out of capital.

Is that argument entirely sound ? It is quite generally understood that the fixed assets, being in the nature of a prepaid charge to the operations in which they will be consumed, are not expected to appear in the balance sheet at market or realisable value, or value to replace, but at cost less the proportionate amount consumed charged to operations. The loss which has been sustained in the capital of the stockholders must then be the loss due to shrinkage in earning power, which is the predominant basis in valuation of capital stock. But under present conditions can that loss be said to be due to overvaluation of the concern's assets and to excess charges for depreciation accruing ? With business volume much below normal, must not volume of business generally increase considerably before it can be judged definitely that the assets have suffered a shrinkage in earning power ? The procedure, as carried out by a considerable number, does somehow give the impression of an impatience to help along income with the nostrum of costs artificially lowered, even though with formality and full legal

sanction. The reduction in plant values is not confined to those cases where values had been increased. If that were so there would seem to be ample justification for returning the valuations to the original cost basis as being a return to conservative accounting practice.

An argument is employed that by reducing fixed asset values and consequently depreciation, the corporations will be in position to compete with concerns erecting plants at to-day's lower costs. This may sound a bit specious in view of the fact that practically no corporations are erecting plants to-day. It might be within the limits of reason to wait until construction of new plants is under way and then revalue existing plants to the cost level which would prevail at that time. Can it be that we should add another cause for obsolescence, namely, superfluity? It almost seems that the real justification for writing off or writing down assets at the present time might be due to this new kind of obsolescence.

It should be said, however, that in many cases assets which had been increased in book value are being written back to cost, rather than to the present price level which is believed by most people to be subnormal, and that the revisions are being made with great care and with consideration of all circumstances, past, present, and what may appear reasonable in the future. There are, no doubt, many capital assets for which no use can be seen in the near future and which have greatly deteriorated, and are therefore being written down to salvage value with very good reason.

But, whereas probably most corporations are making their revisions advisedly, a juncture appears at this time for occasional deliberately irrational changes.

DEPRECIATION—BRITISH AND UNITED STATES INCOME-TAX PRACTICE

The whole question of profits, dividends, and capital is necessarily simpler in Great Britain than in the United States, for the reason that in the States we have the different jurisdictions of 48 states with laws and interpretations somewhat at variance. Uniformity of treatment is had, however, in the application of the Federal Revenue Act, commonly referred to as the income-tax law,

which in its administration necessarily applies the same rules of law and accounting theories throughout the land. To the income-tax law must be attributed a considerable part of the credit for whatever of uniformity there may be in the accounting practices of concerns in the United States.

The principal differences between British and United States income-tax practice in the matter of depreciation and related charges are as follows:—

1. The British provisions are quite general and their application somewhat traditional, except perhaps in the case of shipping, where the procedure is similar to the Federal procedure, and scale of rates, &c., more comprehensive.

In general, the Federal law, regulations, and rulings are precise, and give recognition to a technically developed accounting procedure which is related to a scientifically organised system of large scale production.

2. In determining rates for wear and tear allowances, trade associations appear to play an important part in Britain, and a relatively unimportant part in the United States.

3. Under the British law, losses are carried forward for six years, and allowances for wear and tear not needed as deductions may be carried forward indefinitely.

Under the Federal Law, where a net loss may be carried forward for one year, depreciation is only allowable in the year to which it relates.

4. Under the British law there is an option between the allowance for wear and tear deductible from determined profits, and the deductibility of renewals as an expense.

The Federal law has no such option.

5. The British custom is to base the wear and tear allowance on the written-down balance (except in the case of ships).

The United States practice, generally, is to base deductions for depreciation on the original cost. This method is not, however, compulsory.

6. The British have a claim for obsolescence when sustained.

The Federal law permits obsolescence (from whatever cause) to



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[Photo by Lafayette]

be taken into account in determining the estimated life and the annual deduction.

In addition, the loss on any partly depreciated asset may be determined and deducted in the year in which discarded.

7. Under British practice when an old machine is sold the sales price is credited to the written-down value of the asset account, no profit or loss being taken up, except in case of obsolescence.

In the United States the practice is to credit the asset account with the original cost of the item sold, charge the reserve for depreciation with the sum of the amounts set up therefor, and charge profit and loss with the difference. Simultaneously, profit and loss is credited with the amount realised from the sale. Thus a profit or loss is determined when the asset is disposed of, and the asset account and the reserve for depreciation relate only to items on hand.

U.S. INCOME TAX—EXTRACT QUOTATIONS FROM LAW AND REGULATIONS

Revenue Act of 1932. Deductions from Gross Income.

“ In computing net income there shall be allowed as deductions :

(k) Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence”

Art. 201 of Reg. 77. “ Depreciation.— . . . The proper allowance . . . is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property in the business, equal the basis of the property. . . . Due regard must also be given to expenditures for current upkeep.”

Art. 202. “ Depreciable Property.—The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the

art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. . . . Property kept in repair may, nevertheless, be the subject of a depreciation allowance . . .”

Art. 203. “ Depreciation of intangible property.—Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licences, and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return, or prior thereto, to the satisfaction of the Commissioner. No deduction for depreciation, including obsolescence, is allowable in respect of goodwill.”

Art. 206. “ Obsolescence.—With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost or other basis at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely because, in the opinion of a taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be sustained and cannot be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due.”

A SUMMARY BASED ON THE BRITISH FINANCE ACT OF 1932

Deductible as expenses annually :—

Repairs, &c.

Renewals and repairs of tools, office furniture, &c.

Renewals of plant and machinery, unless a claim is made for wear and tear allowance.

Deductible from profits (or carried forward to future years' profits) :—

Allowance for wear and tear—calculated as a percentage of written-down balance.

Deductible as expenses—when sustained :—

Allowance for obsolescence :—

Written-down cost, less salvage value.

Ships :

Allowance for wear and tear is a percentage rate calculated on cost—instead of being based on written-down value.

Obsolescence :

Not every partly depreciated machine which is discarded is subject to obsolescence allowance. If it were, the difference between the optional claim for wear and tear and the alternative deduction for renewals would be equalised. However, the Inland Revenue Authorities are becoming more lenient in permitting obsolescence allowances.

Where a department is abandoned there is no allowance for obsolescence.

Allowances for wear and tear, not needed, are carried forward indefinitely.

A true comparison of rates permitted under British and American practice is not feasible owing to the greater subdivision in classification in use by the United States Treasury Department. For example, in the British practice engines and boilers seem to be subject to a rate of 5 per cent. in all industries (though in practice possibly there is some variation), while in the United States, rates for engines are given as 4, 5, 6, and $6\frac{1}{4}$ per cent., according to type, and for boilers, 4, $4\frac{1}{2}$, 5, 7, and 10 per cent., according to horsepower and type. Some British rates are higher, as on farm tractors, sulphuric acid plants, and steamships, and some are lower, as on printing type.

From a rather general review, the averages of the rates do not appear to be far apart, but the method of application—in Great Britain on reducing balances (except on ships) and in the United States on the straight line method—would permit a greater allowance in the latter jurisdiction. As a material offset to that advantage, however, is the limitation on the period of time in which allowances not used to reduce taxable income may be carried forward.

Under the heading of methods of depreciation it was indicated that the reducing balance method is much used in Great Britain, while the straight line method is in quite general use in industrial concerns in the United States.

EFFECT OF ANNUAL APPRAISALS

Appraisals are largely resorted to for the following purposes : (1) for the purpose of ascertaining insurable values ; (2) for the purpose of re-establishing asset accounts where the accounts over a period of years have been improperly, badly, or inconsistently operated, making appraisal the most practical means of starting afresh ; (3) for the purpose of sale of the property, stock issues, and bond issues ; (4) for the purpose of recognising and stating increased values in the accounts as a basis for a capital surplus credit ; (5) and recently, for the purpose of recognising and stating in the accounts decreased values, having as a corollary decreased depreciation charges ; (6) for the purposes of recognising increased replacement cost, having as a corollary the setting of sales prices or rates on a basis estimated to recover a fair return on such values instead of on actual expended costs.

Appraisals may also be had annually for the purpose of ascertaining the monetary value of depreciation as measured by current costs.

Discussion of the effect of appraisals in the instances numbered 1, 2, and 3 is unnecessary to our subject. The effects, when entered on the accounts, of appraisals in instances numbered 4 and 5, relating to revisions of capital assets upward or downward, have already been touched upon in this paper.

Utility corporations seeking the establishment of rates which will yield a certain return on the value of properties have contended that the present value of properties is the proper base for determining

rates. There has been much litigation on this point, but the United States Supreme Court finally upheld the contention of the corporations. (Case of *Southwestern Bell Telephone Co. v. Public Service Commission*—262 U.S. 276.) Two members of that Court, however, dissented from the majority decision and rendered the opinion that the capital, properly invested, should be the base.

I do not know if the Courts have ever been petitioned to establish, or permit, the practice of using frequent or periodical appraisals to provide a base upon which to adjust, from time to time, the rates that would be legal. Naturally such a practice, if put into effect, might result in reduced rates in years of depression and reduced costs of capital goods.

Possibly a theoretical re-appraisal could be had at annual intervals by a consideration of the percentage change in the purchasing power of the dollar when invested in those items constituting the properties, taking into consideration the changes in the interval in the properties through purchase, sale, and obsolescence.

Some smaller concerns have their properties appraised annually, but I am of the opinion that the practice is almost entirely for the purpose of insurance and not for the determination of annual depreciation. The values in such appraisals are sometimes incorporated in a footnote as a reference to the fixed asset accounts in the balance sheet to indicate current appraisal values.

As stated at the beginning, appraisals serve several useful purposes. To restate the accounts annually on the basis of appraisal values and write off the difference as depreciation or set it up as appreciation seems to me to depart from the sound accounting theory that when investment is made in a wasting capital asset it is for the purpose of consumption over a period of years in the production of a service or commodity to be sold, and is not itself a commodity primarily held for sale. The recovery of the investment, in order to maintain the capital of the enterprise intact, is therefore the main function of depreciation charges through the operation of which there is withheld from income the proper proportional part of the initial outlay applicable to the income period.

If labour and material costs of capital goods rose consistently and

continuously, and were bound to continue in that direction indefinitely, serious consideration would have to be given to the question if it would not be desirable to advance stated values of capital assets in order to lay aside adequate funds for replacement. Under such circumstances, however, with a constant and even shrinkage in the purchasing value of the dollar, the profits as measured in dollars should be sufficiently large so that an adequate surplus might be set aside to provide for the increase in cost of replacements.

However, we know out of our own experience that costs as measured in the terms of money do not advance indefinitely ; that reactions and settling processes occur periodically which appear to form a new base. I am firmly of the opinion that accountants are economically correct in advocating a theory of replacement of investment in fixed assets through charges against income, so that sufficient of the revenues may be set aside to maintain the capital paid in intact in the monetary terms in which it was paid. That which was paid in in dollars should not be required to be kept intact in terms of bricks, steel or other commodities or manufactured goods. To attempt anything further at this time would seem to involve a species of political economy which can provide equal justice in treatment, as measured by monetary units varying in purchasing power from time to time, to long term creditors, long term debtors, and owners of business enterprises—and that has not yet been developed.

IN CONCLUSION

In the United States a condition of accelerating interest is shown in the methods of stating accounts, in the scope of examinations, and in the information contained in reports of companies. In the move for better accounting practice by corporations, the New York Stock Exchange is taking an important part and the American Institute of Accountants is affording it full co-operation. In connection with our subject, it is interesting to note the reference to property valuations and depreciation policy in a letter issued by that Exchange under date of 12th January 1932, addressed to the chief executives of corporations, and advising of its general attitude as to certain features in annual reports. These references are as follows :—

“ (7) Full disclosure should be given of any change since the previous annual report in the basis of valuations in investments, inventories, or property account.

“ (8) Full disclosure of any change in the depreciation policy should be given.”

All accountants know that the operating results recorded in the books of account may vary considerably with different methods of applying charges for depreciation and obsolescence, and they would also differ materially with different methods applied in the same concern. It is, therefore, of great importance that, if the basis adopted in a case appears to be sound, it should not be discarded in favour of a different basis or different rates without keen inquiry to ascertain that the changes are entirely justified by circumstances ; and it would certainly be unfair to stockholders and misleading to prospective investors or credit grantors to receive financial reports for a year on a basis differing from that of the previous period without being put on notice as to the change.

In presenting this paper from the American viewpoint, as requested, various phases of the subject have been touched upon but briefly. Some of these are worthy of extended treatment which is not possible within the limits of a paper. Phenomena in the changing industrial economic situation have been mentioned as they are inseparable from current problems of depreciation. The subject is, therefore, one which cannot fail to be of deep interest at this time, especially to the accounting profession. I consider myself amply rewarded for my efforts by the stimulation of thought I myself have received in concentration on this subject.

DISCUSSION

THE CHAIRMAN : My Lord President, ladies and gentlemen, I think you will all agree that the question of depreciation and obsolescence, after a very strenuous week, is a very apt subject and one that may well be discussed at the end of the work we have done. The question of depreciation is one that Mr. Howitt will deal with, and when I look around this platform and see Lord Plender here I think you will agree that the question of obsolescence is one that we need not trouble very much about. (Hear, hear, and laughter.) Without undue delay I will call on Mr. Howitt briefly to introduce his paper.

Mr. H. G. HOWITT, D.S.O., M.C., F.C.A. (Great Britain) : Mr. Chairman, Lord Plender, ladies and gentlemen, in preparing my paper I had primarily two objectives in mind. Firstly, to review the advice which as a profession we can give to the commercial community to help it in the difficult times through which it is passing, and, secondly, to consider the manner in which the published accounts of businesses should deal with depreciation, so that in regard to the principles underlying the statement of fixed asset values, those accounts should at least be correctly understood. As a preliminary, I felt compelled to sketch the groundwork of the problem without repeating more than seemed necessary of elementary matters with which accountants are familiar.

I also touched on income-tax matters, and tried to show the wide effect which proper depreciation provision and allowances, both for taxation and other purposes, may have on the development of an industry.

I next considered the objects of depreciation charges, the choice of policies to be pursued, and the different methods available.

The objects are stated to be twofold—firstly, to ensure the correct treatment of annual accounts, and, secondly, to guide the manufacturer as to the correct charge for costing purposes with a view to selling. Policies also are classified into two main categories, namely, the policy which looks upon depreciation as a charge to write off past cost, and the policy which has more regard to the future and to the provision for

replacement by comparable assets, although their cost may be different from that of the assets replaced.

Finally, I have detailed with appropriate tables, the various methods available in the attainment of these objects and policies, but I have not attempted to choose between them, feeling that a given method is not necessarily the most suited to all businesses, and that within certain limits each company should be entitled to choose its own policy and method. I have also touched generally on the uses and limitations of appraisal, emphasising that in the majority of cases an annual appraisal of fixed assets is of no use for commercial accounting purposes.

Having disposed of this groundwork, I then ventured into the more controversial realm of the auditor's responsibilities in regard to the problem, bearing in mind such legal guidance as is available to him. I have tried in particular to find common ground so that as a profession we may speak with one voice, and most usefully serve the double function to which I first referred.

With regard to the first function, we can, of course, assist our clients in the choice of method most suitable to their particular requirements. We can also emphasise that depreciation is a real operating cost which must be provided irrespective of the amount of profits available, and we can emphasise the need to ensure that a reasonable proportion of the depreciation fund is kept liquid.

In regard to published accounts, we need to draw a distinct line as between matters on which we must insist, and matters on which we are only entitled to tender advice. In the former category is included the requirement that a proper charge shall be made for the period under audit, and that as between different accounting periods the provision shall be made on a reasonably uniform basis. In the latter category we should include a strong recommendation that the provision made for the year should be separately shown in the accounts, and that the total provision for depreciation to date so far as available against existing assets should be shown separately on the balance sheet where it can be compared with the gross cost of those assets and with the liquid funds available for their replacement.

There is no royal road to perfection in such matters, and I have not presumed to point one out. I have, however, ventured to suggest certain principles which I hope may be accepted, bearing in mind that a real contribution is to-day expected of us towards the re-establishment of industry, and towards the proper statement of its accounting records.

MR. A. S. FEDDE, C.P.A. (United States of America) : Mr. Chairman, my Lord President, ladies and gentlemen, the Chairman has allowed me a very few minutes. A paper covering a subject as large as this must necessarily be in rather summary form, and then to present it again in a summary of two or three minutes involves really the impossible. I would, however, say this, that the accounting view of depreciation has been stated as differing from the general view, or from the general acceptance of the term as used by the layman ; that is to say, as meaning loss in value. That the accountant generally applies to securities or things having a readily marketable value. Mr. P. D. Leake at the last annual meeting of Chartered Accountants, I think, suggested a very apt designation for depreciation as used by accountants when he used the title of "expired capital outlay." In the paper I have also given a little space to contrasting the straight-line method as in use in the United States and the reducing balance method as largely used in Great Britain, and showing also how the income-tax practice has followed the general business practice in each of the countries. In the Inland Revenue they permit depreciation on the reducing balance method, whereas the Internal Revenue Department in the United States follows the plan of allowing the depreciation on the straight-line method. That may be of some interest to our British brethren.

The question of obsolescence in the United States I think is more important than in Europe. An American has only to take a train through any country in Europe, or a car through the streets of a European city, to note the contrast in degree of obsolescence between European capital assets and American capital assets. New building and replacement of all kinds is so much more in evidence in America. Can it be that Europeans insist on wearing out their capital assets even though usefulness has diminished by partial obsolescence ? Or, perhaps, the Americans are too impatient of the present.

The situation at this time is complicated by the extreme fluctuation in values and in costs of all kinds, including the costs of capital goods, which makes the business man fearful of competition from others who may have constructed production units at lower cost or who may have purchased defunct companies at a fraction of original cost. Difficulties also attend the earning of a net profit by reason of the cost incurred in maintaining idle plant units. In some cases these excess facilities have been regarded as permanently superfluous and that—for all practical purposes—they should be considered as though obsolete. The subject, therefore,

seems to divide itself, at this time particularly, into two main divisions, namely, methods of technique in ordinary times, and methods or measures which shall be deemed proper when ordinary costs of capital goods are dislocated by violent price fluctuations.

It was interesting to me to see in *The Journal of Commerce* of New York, dated 8th June—that is to say, two or three months after my paper was written—a short paragraph stating that : “ In some circumstances in fact actual plant valuations are now rising well above the reduced balances carried on the books, resulting in the creation of what amounts to secret reserves.” I shall be very interested in hearing the discussion on this matter, not so much as to the ordinary technique, which we can gain from practically any kind of text book—I do not think this is an elementary school—but as to principles which might be deemed to be both sound and practical. (Applause.)

MR. R. A. WETHERALL, F.I.M.T.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, I feel that the Congress is indebted to Mr. Howitt, not only for the adequate treatment of his subject in the paper he has submitted, but also, particularly, for the charming introduction. That delightful quotation from “ *The Tempest* ” wholly succeeds in its emphasis of the transitoriness of this world’s glory without suggesting the essential morbidity of the ideas expressed in the terms “ depreciation ” and “ obsolescence,” and, thereby, induces a suitable frame of mind in which to discuss the accounting aspect of our subject.

It is never safe to press an analogy too far—and this is especially true of a poetical analogy—and so I do not think the author is quite justified in suggesting that Shakespeare denies the possibility of a scrap value to material assets. It is unnecessary to plead poetic licence in defence since the poet deals faithfully with the conditions he portrays. When “ the great globe itself, *and all which it inherit* shall have dissolved, there can be no residual value even in a cloud-capped tower ! ”

Neither, however, must this criticism be pressed too far.

The author does well, at the very outset, to refer to the confusion of thought which exists in regard to depreciation in its accountancy aspect, and to insist that its function in that aspect is to spread capital outlay over the period of the effective life of the assets employed. Such a view—and in this gathering it must be accepted as the correct one—rules out altogether appraisals as a method of securing the provision of depreciation in accounts. The author rightly points out, however, that although “ appraisal ” is unsatisfactory as a measure of depreciation it can be

used as a means of checking the estimate which is made based upon the effective life of the asset.

The problem of method, as the author points out, is a very difficult one. His treatment of that part of his paper is both orthodox and adequate, but I should like to refer to one or two considerations suggested by his remarks.

Except where otherwise determined by law or by the nature of the asset, the question of what is the period of effective life is one for the engineer or other technical officer, and the method of providing depreciation in the accounts is for the accountant, although best results will be achieved when there is complete collaboration between the two in the determination of both.

It is not sufficient merely to spread the capital outlay over the whole period of the effective life of the asset as so ascertained, but, as far as possible, it should be spread equitably over the different accounting periods making up that life.

The accountant claims that he has to deal with *facts* in his accounts, but absolute accuracy is impossible where estimates are involved as in this question of depreciation. In such circumstances the accountant tempers accuracy with prudence by erring on the safe side. This combination of qualities largely constitutes the accountant's professional pride, yet, in fact, they are conflicting and, speaking generally, the more prudence is reflected in accounts, the less accuracy is there in the results shown by the accounts.

The author commends the prudent course of adopting the shortest period of estimated life where different periods are obtained based on "use" and "obsolescence" and he counts it an advantage of the fixed percentage on reducing balance method of providing depreciation that the greater provision is made in the earlier years of the asset's life. It is a paradox of accountancy that in the uncertain days when prudence is especially called for, the restricted revenues of an undertaking make it difficult, if not impossible, to take the prudent course.

Now, the effective life of a material asset, based on "use," is capable of fairly close estimate but the factor of "obsolescence" is uncertain and unstable. Would not greater accuracy in accounts be obtained by making separate provision for the two factors? Obsolescence is admittedly a factor of depreciation, but, from the accounting point of view, there is no reason why the provision should not be split into its components, "wear and tear" and "obsolescence" (following, in this respect, the income-tax practice), the one being a "charge" in the accounts and the

other a general appropriation of revenue by way of "reserve."

Another question affecting the spread of capital outlay over its effective life, or, rather perhaps, in estimating the effective life of an asset, is that of "load factor." The author refers to a variation of the usual application of the "straight-line" method of providing depreciation, based on output which, as a basis, is subject to the weakness mentioned. On the assumption that the estimated life of a piece of "plant" is measured on its rated capacity, it is not unreasonable to claim, as some engineers do claim, that the running of the plant on a lower load factor would normally extend the estimated life. As I have previously indicated, I regard this as a question for the engineer in the first instance, but it would be interesting to have the author's views on the question.

I note that the author declines to choose between the different methods of providing for depreciation on the grounds that each is especially suitable for particular cases, but I think, perhaps, he is a little unfair to the merits of the method of "fixed percentage on reducing balance" to state as a disadvantage of the method that some of those who use it fail to adopt a rate which will satisfy the condition that the capital outlay should be written off over the effective life.

As a municipal financial officer I am rather disappointed to find the statement that the "sinking-fund" method of providing depreciation is seldom adopted for commercial purposes in this country. It is, of course, the method imposed on municipalities in all their public utility undertakings by the conditions under which, alone, they can finance their capital expenditure.

I am glad to note that the author accepts the view that the sinking-fund contribution by local authorities in respect of trading undertakings does provide adequate depreciation. This view was not always generally accepted and I am just old enough to remember the question as a rather lively controversy.

It is the declared policy of the loan sanctioning authorities to base the period of the loan sanction on the estimated life of the asset and, in fixing this period, to adopt a "safe" figure, and it is a common experience that the asset acquired outlives the loan period. In this connection some interesting problems of obsolescence are likely to be raised when the national electricity grid is fully operative since a generating station will only be permitted to continue an isolated existence so long as it can be shown that the cost of generation is not greater than the price at which a bulk supply could be obtained from the "grid." The Electricity Com-

missioners have it in their power to decide in such cases that the loss by "obsolescence" need not be written off in the accounting period in which it may occur, but may be spread over a period.

On the broad questions of policy there will be general agreement with the views expressed by the author that the depreciation charge in accounts should be restricted to the amortisation of the original cost, and that anything in addition to this should be met by a general appropriation of revenue from time to time. Any attempt to adjust the annual charge to provide for "replacement value" on the logical basis described by the author would mean an involved calculation without ensuring greater accuracy in the accounts.

The general observations of the author are not the least valuable part of his paper, and I find myself so far in agreement that it is unnecessary for me to review them. I may, perhaps, say that his suggestion in regard to declarations by public companies of the policy and methods of depreciation adopted, and the amount provided in accounts to carry such policy into effect, are not only reasonable in themselves, but would assist in securing more universal recognition of the limitations of a balance sheet.

The old plea of the necessity for secrecy which was held in the past to justify vagueness and ambiguity in published accounts cannot, in these days, be seriously advanced, and there will be general agreement with the view that published accounts should, at least, be capable of correct interpretation in regard to the very important aspect of depreciation. (Applause.)

PROFESSOR HENRY RAND HATFIELD (UNIVERSITY OF CALIFORNIA) (United States of America): Mr. Chairman, my Lord President, ladies and gentlemen, the paper of Mr. Fedde leaves unsettled some questions which should be discussed by this Congress. Among these are:—

1. What is the purpose of the depreciation charge? Is it, as the author says, on page 657, to prorate initial expense; or, as stated on page 675, "to maintain the capital intact"; or "to provide a reserve for replacement" (p. 667) or, finally, to obtain comparable operating costs (p. 660)?

These expressions are not synonymous nor compatible. Comparable figures must include all, not merely initial costs. Maintenance of capital cannot be the purpose of a depreciation charge, for depreciation should be shown even when capital is being depleted. Provision of a reserve is, in my opinion, a financial procedure not an accounting concept.

2. Is the total amount to be charged as operating expense the exact initial cost?

- (a) Is it not inconsistent to advocate a reduction in the annual depreciation charge, in case of obsolescence (p. 660) while strongly opposing a similar adjustment when the value of the machine has changed from some other cause (p. 669) ? Is not a modification necessary in either case, if comparable costs are to be ascertained ?
- (b) While it is true that "it is quite generally understood that the fixed assets . . . are not to appear in the balance sheet" at other than cost less depreciation (p. 668), should not the author give a logical, not merely a dogmatic basis for this doctrine ?

Consideration may, for the present, be limited to a real change in value, disregarding a rise in prices due to inflation. An illustration may make the problem clearer. A man bought \$10,000 United States bonds at 90. Later he paid them in purchasing real estate worth \$10,000; the seller being willing to take payment either in cash or in bonds at their then market price, par. Did the real estate cost the purchaser \$9,000 or \$10,000 ? Did not the value surrendered accurately measure the cost ? Would the situation differ if raw cotton costing \$9,000 were held for some time in a rising market and manufactured into cloth when it had an undisputed value of \$10,000 ? Does it make a material difference whether cotton is consumed, or a certain proportion of the then value of, say, a steamship ? I am myself uncertain what answers should be given. But it is not satisfying to have an answer based merely on what "is quite generally understood" to be a correct view. Not satisfying because there are accountants, notably Professor Fritz Schmidt of Frankfurt, who strongly oppose the accepted view ; and furthermore because one recalls that though it was once "generally understood" that the sun went around the earth, that theory is now quite discredited.

3. How is the total depreciation to be allocated to the several years ?

- (a) Eight methods are given in the paper. Of these two, the sinking fund method and the reserve method are not distinct methods alternative, say, to the straight-line method. But this leaves six suggested methods. Can all be correct ? What are the circumstances, to which the author refers, which prescribe for America a method different to that prevailing in Great Britain. In ascertaining the profits earned, is it a matter of indifference whether the charge on a machine which costs \$100,000 is figured for the twentieth year at \$808, or \$4,750 or \$6,728 ?

The several methods are different, and contradictory in principle. I am enough of an Hegelian at least to desire, when con-

fronted by apparently contradictory principles, that an attempt be made to find some synthesis, which shows that while procedures may vary with differing conditions they all conform to one fundamental principle.

There is no intimation of such a principle in this paper, and little hint of it in all accounting literature.

- (b) The author is careless in seeming to imply that the reducing-balance method writes off the total depreciation less rapidly than does the straight-line method. It is improper to compare, as is so often done, the use of an adequate rate in one method with the use of an insufficient rate in the other. The essential feature of any method is that enough be charged from year to year to cover the depreciation during the useful life of the machine. The use of an insufficient rate is not a method of allocating depreciation but the lack of a method for doing this.
 - (c) Is the predilection for a system, which tends towards equalising total costs in the several years, desirable? If repairs become greater as years go by, is it desirable to conceal that fact by a somewhat similar decrease in the depreciation charge? Does that not tend to prevent a prompt recognition that it is advisable to discard the machine?
4. Two specific criticisms may be made in closing :—
- (a) A minor one is the author's use of that deplorable phrase, "depreciation is a provision out of profits." It is admitted that he really does not mean it; and that everyone else, his critic included, has used the phrase. Provision relates to what may happen in the future. One may lay aside cash to provide for a future purchase. But depreciation represents what has already taken place, that value has been consumed. Depreciation does not provide for this. It merely records the fact.
- It would be worse than bringing coals to Newcastle to argue before this Congress that depreciation cannot come out of what is left after depreciation has already been subtracted. But a pious wish is expressed that we all abstain from any further use of this inaccurate and sometimes misleading phrase.
- (b) The other criticism concerns the author's attitude regarding a general rise in prices due to inflation. He states that all that is needed is "to maintain the capital . . . in the monetary terms in which it was paid" and that even with continuously rising prices

“profits as measured in dollars should be sufficiently large” to provide for replacements (p. 675).

The unfortunate thing is that unless regard is paid to the changing value of money, profits are not shown, but a misleading figure is given which is falsely labelled profits. If one buys an article for a dollar, when the dollar is worth 5s. 8d., and sells it for \$1.10, when the dollar is worth only 4s. 2d. (I pay you the compliment of assuming the pound has not changed in value), there is not a profit of 10 per cent.; but a loss of some 19 per cent.

It is true that accounting has generally been based on the assumption of the permanency of the monetary unit. But we know this assumption is false. In the great inflation in Germany it was, necessarily, abandoned by accountants. Perhaps we in America will have to admit its unsoundness, on practical as well as on theoretical grounds. (Applause.)

MR. P. D. LEAKE, F.C.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, I should like, in the first place, to join in heartily thanking Mr. Howitt and Mr. Fedde for their valuable papers. Each has dealt fully and ably with the subject of depreciation in its widest aspects as viewed in this country, and in America respectively. As Mr. Howitt truly says : “Depreciation is the most important, as it is the most difficult, of all accountancy considerations.” I confess to being almost appalled at these difficulties, but they must be boldly tackled. As regards tangible assets and depreciation, our duty as accountants is, I think, to endeavour rightly to allocate the user's original cost to each accounting period over the term of the useful life of the capital outlay. The problem is, of course, how this should be done. With considerable diffidence I desire to advocate two propositions :—(1) That we must regard the capital of a profit-seeking undertaking as one whole or single unit, notwithstanding that its constituent sections, or parts, are constantly changing *inter se*; consequently, that in measuring expired capital outlay—a better term, I think, than the word depreciation—on any particular section of the capital, in the process of computing annual profit and loss, the use of annual interest, involved in the sinking fund and annuity methods, should be avoided. (2) That in measuring expired capital outlay, we need the systematic co-operation and assistance of the engineers and others in charge of the material assets.

As we know, industrial capital consists, not of money, but of things. Real capital is tangible things in the form of useful materials and commodities, such as lands in possession, factories, mills and their contents, grow-

ing crops, live and dead stock, railways, shipping, mines, plant, machinery, raw materials, manufactured goods, and lastly, metallic money, which latter probably represents no more than about one per cent. of our industrial capital. Now my point is that material assets dedicated to industrial profit-seeking cannot earn interest, apart from the profit or loss resulting from the undertaking. Interest is itself profit, and therefore cannot be distinguished from profit. It seems to me that the only form of material assets which can properly be regarded as earning interest is money, and the right to the receipt of money, as in the case of a purchased annuity.

In support of this view let me take, as an example, a section of industrial capital consisting of a coalfield, and suppose that at the end of a period of ten years one half of the original contents has been raised and marketed. In that case, half that particular section of the capital, and, therefore, half the original cost, has expired or been used up. A transfer from one undertaker to another at the end of ten years does not, in any way, affect the position in this respect. It seems to me that the original cost of a coal field expires parallel with the exhaustion of its contents, just as surely as the original cost of a box of gold sovereigns may be said to expire parallel with the removal of the contents; and so likewise, the original cost of plant expires parallel with the exhaustion of its useful capacity.

But if we return for a moment to the coal field we may get a glimpse of the possible action of something very like the interest factor; because it is quite probable that on a sale and transfer of a coal mining business as a going concern the circumstance that the seller has been obliged to carry a larger quantity of material in the coal field during his time than the buyer will carry, may contribute in an obscure, but important way to any value existing at that time in the nature of goodwill. The point I wish to make is that the mere accident that the seller has temporarily owned the whole of the coal field does not alter the fact that half of that section of the material capital originally represented by unwon coal has gone. In the meantime the money gradually released through revenue to answer the expired capital outlay will probably have been retained in the business and applied to some other form of capital outlay. But if, on the other hand, the capital in money form became redundant, and was partly repaid, then, if the future annual profits were not reduced, this happy state of affairs will naturally be reflected in a rise in the value of the goodwill or in the market price of the shares.

On the other hand, profit, or interest in lieu of profit, is an inevitable

part of the cost of constructing plant, whether the work is done by outside contractors, or, as sometimes happens, in the case, for instance, of a railway company, by the undertaking itself. But from the time that material assets are ready for use and are actually applied in profit-seeking, either to be sold in detail, or to be gradually used up, they become part of the capital of an undertaking. And while they continue to exist as material assets, they obviously cannot earn anything apart from the profit or loss of the undertaking, of which they form part.

Therefore, in accounting for capital outlay on material assets, other than a purchased annuity, the use of annual interest and of all devices like the annuity and sinking fund methods which involve considerations of annual interest, should be avoided. If we could get a common agreement amongst accountants that considerations of interest must be excluded in measuring annual expired capital outlay on tangible things, we should avoid many dangerous practices, and we should simplify the subject of depreciation.

And now I come to my second proposition that accountants need the systematic co-operation and assistance of the engineers and others in charge of material assets. It is, as we know, things which represent the greater part of industrial capital outlay, and the accountant wants current information, and to be kept in close and continuous touch, not only with the varying quantities of material assets in industry, but also with the changing condition, and the behaviour of those things, and with their future outlook, so that he may rightly allocate as a charge to revenue a proper proportion of original cost as the things themselves are gradually used up, or as they expire over each accounting period.

The common commercial view of the going-concern value of industrial plant, which represents the greater part of industrial capital, is that the value is based upon the unexpired capital outlay on that plant, computed by deducting from the cost, less estimated residual value, an equal annual instalment of that cost in respect of each year of the estimated efficient life which has expired. In selling a going concern to a company or individual the view of our Arbitration Courts is that the proper basis of the value of the plant—except tools and utensils which are subject to actual count or inventory—is the so ascertained “going-concern” value adjusted in respect of subsequent fluctuations in the cost of material and labour, as bearing upon the possible price of new plant. I refer particularly to the well-known tramways and national telephone arbitration cases.

I think that all profit-seeking undertakings using any class of industrial plant should keep suitable accounting records in the form of a register of plant, apart altogether from the ordinary financial ledgers, to enable expired capital outlay to be measured on a settled basis, and deducted each year from the cost of each class of plant. Many years' history of any number of different classes of industrial plant can be recorded in a suitably planned register of plant without any confusion, and with a minimum of clerical labour.

There would then always be a permanent record available showing the classification of all capital outlay on industrial plant, and a direct connection would be maintained between the actually existing plant and the going-concern value of that plant as shown in the financial books, and in the annual balance sheet. The up-to-date records in the register of plant required for this purpose call for the aid and co-operation of both engineers and accountants, suitable provision being made for : (1) The regular observation and record by the engineers of the behaviour of, and the changing conditions affecting, each class of industrial plant representing capital outlay ; (2) The use of suitable accounting equipment capable of enabling the results of such observation and record to be clearly reflected in the annual accounts ; together with the adoption of a settled and continuous financial policy under which each year's revenue shall be charged with a regularly measured sum based on the engineers' observations as to the extent, condition and prospects of the plant. Nothing except current attention of this kind can ensure the maintenance of capital value, and the co-related correct computation of annual profits.

If these two propositions which I have endeavoured to outline could be generally accepted, the subject of depreciation including obsolescence which cannot be treated separately from depreciation—both are covered by the term "expired capital outlay"—would become a comparatively simple matter. We should then certainly avoid the employment of what is called the reducing balance of cost method of measuring annual depreciation ; we should also avoid the use of the sinking fund or annuity methods ; and we should not have to call for annual appraisals of plant. In fact, we should find ourselves in a comparatively happy accounting world.

In conclusion, I should like to refer for a moment to such assets as goodwill, patent rights, &c., which, although they may have great exchangeable value, yet they are only paper assets. They are intangible assets, and they appear in a balance sheet only on sufferance. Such

entries in a balance sheet are really in the nature of accounting memoranda recording the fact—important no doubt to the individual or company—that real capital has been advanced in exchange for rights to future super-profits if, and when, those super-profits arise. Intangible assets represent nothing which exists, and are not real capital. Unlike the case of tangible assets, except purchased annuities, annual interest is an important factor in computing the value, at any time, of intangible assets. There is an essential difference between the outlay of money, that is real capital, for the purchase of an annuity, and the advance of money for the purchase of goodwill. Whereas a purchased annuity involves the gradual return of the capital outlay, together with agreed interest which it will gather in the meantime, the purchase of goodwill involves no return of the capital advanced, but gives the right to receive expected future super-profits, which may, or may not, thereafter arise. The purchase of an annuity is rightly described as capital outlay, an exchange of real capital against the right to the future repayment of that real capital; while the purchase of such assets as goodwill and patent rights is better described as capital advance—being an exchange of real capital for right to nothing which exists, but only to that which it is hoped may arise in the future. In the case of joint-stock companies, I should like to see all such intangible assets represented either by shares of no par value—which could be issued to the public for cash at the price they would fetch—or by the premium over par value at which the shares of fixed amount are quoted on the market. Share capital of fixed amount should always be represented by the going-concern values of tangible assets, the difference after adjusting liabilities being plainly declared as surplus or deficit.

We are dealing with a very difficult subject, and there is, perhaps, a natural tendency outside the profession to view with scepticism attempts to systematise it, but we should not encourage that attitude. On the other hand, original thought should be encouraged, and new suggestions welcomed even though these are outside our present habits of thought and custom. I hope that as an outcome of this International Congress we may have definite and concrete suggestions from others of our colleagues much better able than I to deal with the subject. We should take good care to hold tight to the right and reject the wrong, otherwise we shall make no progress, and among such talk we may miss those suggestions which are really good and practicable. Let us bear in mind the homely phrase: "It would be foolish to throw away the baby with the bath water." (Laughter and applause.)

MR. J. PELSER, Jr. (Holland) : Mr. Chairman, my Lord President, ladies, and gentlemen, I have had great pleasure in taking notice of the two papers on the subject of depreciation and obsolescence submitted by Mr. Howitt and Mr. Fedde.

It is not my intention to follow closely the argumentation of our esteemed colleague, but I should like to add a few observations which have more particularly struck me. I specially wish to refer to what Mr. Howitt states on page 645 of his paper ; he practically states there that it would be wise if in future less durable or permanent and less expensive buildings, machinery and plant were put down, in other words more or less semi-permanent installations which could be more rapidly written off and which would therefore present few or no difficulties on account of obsolescence.

If this paper did not contain anything beyond this conclusion, which is completely covered by the preceding argumentation, then this paper would be perfectly justified for this reason alone. We have all of us probably had this more or less in mind, but the great merit of Mr. Howitt has been that he has explained in a most lucid manner why one will have to take this point more seriously into consideration in the future.

May I be permitted to illustrate Mr. Howitt's argument with a single example ? In various countries, particularly the older civilisations, it has ultimately been found by means of experiments and improvements in what manner a product could be most economically produced. The countries where such an industry has but recently been created or developed have generously profited by the experiences of other countries and were able to equip their industries immediately on the most economical basis. A striking example is the extraordinary development which has been seen in the industry of Japan, where naturally the low rate of wages also plays a part. But even without the low wages, modern equipment can afford a considerable advantage, as is the case, for instance, in the Dutch coal mines, an industry which dates from the first few years of this century. In spite of the fact that the strata are at a very deep level they can very well compete with foreign coals. All this, therefore, points to the fact that we cannot and may not postpone the depreciation or scrapping of obsolete mechanical plant until it is worn out, but that the industry must be able by means of a more rapid depreciation to scrap such plant as is no longer adapted to the improved methods of production.

Another point which is immediately connected with this, and which

I should like to add to Mr. Howitt's argument, is the saving in interest obtained by installing less costly plant, which has a so much shorter life and consequently must be renewed so much sooner. If we bear in mind that capital at an interest of 5 per cent. is doubled after about 14 years, it follows that instead of an extremely durable plant, costing about £100,000, it would be much wiser, if possible, to build one not quite so durable of about £50,000, seeing that the interest on £50,000 saved will enable us to build an entirely new, less permanent installation which will then meet all up-to-date requirements.

As our time is limited there is only one point which I should like to make. Neither of the papers submitted pay, in my opinion, sufficient attention to the system of depreciation which has existed for quite a long time and is still applied by many business men. It is a system which until quite recently was not considered a system at all, and was for a long time set aside by the theoreticians as being absolutely unscientific, but which is still being applied and will always be applied by hardheaded business men and manufacturers. I refer to the determination of the amount of depreciation in proportion to the amount of profit earned, namely a large depreciation when there is a large profit and a small depreciation when there is a small profit or a loss. I should like to defend this system and to explain it as follows: If in a certain branch of business a considerable profit in comparison with the amount of capital is earned this will create or excite competition. Industries are expanded and new ones are established and within a few years the entire production apparatus is increased to such a degree that the margin of profit is reduced, owing to competition, to more normal proportions, and in many cases there is no longer question of profit at all. A certain proportion of the producing plant has then become superfluous; the remainder is still operative but the margin of profit is considerably reduced or has completely disappeared. Consequently it seems to me to be logical that in the boom years in which large profits are earned large depreciations should be written off, seeing that in subsequent years the profits will no longer be sufficient to write off the necessary depreciation. Numerous examples can be quoted of this process. I need only mention the boom in freights after the War resulting in the feverish construction of tonnage and the present deplorable condition of the shipping companies. Other examples are the wireless industry and in certain respects the petroleum industry, the Colonial plantations, and so forth. The present economic war, which has given rise to all kinds of protective and repressive measures, such as import-prohibitions, rationing,

&c., have enabled many industries to be established in such countries. It is obvious that a large depreciation is urgently necessary in such cases. I would therefore like to suggest that, as a rule, in times of large profits, correspondingly large amounts should be written off, especially in those cases where extensions have been carried out during this time. There are naturally exceptions, such as legal or natural monopolies, patents, exceptional management, which may permit of such large profits being made during a number of years without risk of competition that any extra depreciation is not required. Modern times have taught us, however, that one must be very careful in this respect, as a new invention can destroy a monopoly at a blow.

I should like to thank Mr. Howitt and Mr. Fedde for the most instructive work which they have submitted to this Congress and for the opportunity which they have granted me of saying a few words in connection with their views. I thank you. (Applause.)

MR. R. N. CARTER, F.C.A. (Great Britain): Mr. Chairman, Lord Plender, ladies and gentlemen, may I in the first place add my congratulations to the readers of the papers. Mr. Fedde's paper is of particular interest to us as accountants, as showing the distinction between the practice here and that over the water.

I trust I am not unduly optimistic in hoping that Mr. Howitt's paper may find its way into the hands of the public, who from it will understand the difficulties of the matter from the balance sheet point of view, and cannot be too emphatically informed as to the amount still standing in the books when machinery is without a diminishing value.

Mr. Fedde has hit the nail on the head in his suggestion that one of the chief grounds of obsolescence is superfluity. I had a striking illustration of this about 12 months ago, when, whilst seeking a mill for foreign clients, I found in one town 18 mills out of 20 standing idle.

It would apparently be impossible to foresee such a condition of affairs, and it would seem sound to provide normal depreciation based on life and to leave these exceptional cases to be dealt with by capital reduction. In my view the re-valuation principle can scarcely be of much value except when a sale is likely to take place. What can be the intrinsic value of anything where you have the elements of superfluity and no intention of sale?

It may probably be within the knowledge of most of you that the statutory obsolescence allowance for income-tax purposes was initiated by a concession given on representations by the Leicester Chamber of

Commerce. (Incidentally I would stress the aid that Chambers of Commerce can be to traders in pressing for needful amendments in income-tax legislation.) The concession was given in view of the fact that certain machinery—though in perfect working order—had of necessity to be replaced by machinery of new and improved types. When the concession was made statutory the original principle was maintained ; that is to say (1) it did not —generally speaking—apply to a thing worn out ; (2) there had to be renewal.

In practice the “wearing out” principle has been modified, and usually speaking the difference—really inadequate depreciation—is now allowed.

It is interesting to observe that in America obsolescence is allowed without renewal. We can scarcely have that here, under our existing legislation, as it would amount to an allowance for lost capital. Equally we cannot have any allowance for improvement in the process of renewal of obsolete items. That would give the old concern an advantage over a new one.

There is much to be said for leaving capital assets at cost and stating the total provided for depreciation. That is a custom almost universal in the cotton trade.

It is difficult to define the position of the auditor as to past depreciation not provided for. The profit and loss account may be right for the year and the balance sheet wrong—just the reverse position to that which happened in the *Royal Mail* case.

Income-tax requirements have reversed the audit lessons of our young days, when we were urged to see that no revenue items went to capital ; now our watch has to be that no capital items go to revenue. Controversy raged some little time ago—I think in Glasgow—as to whether depreciation and sinking fund were both necessary. The fear was then expressed that the whole thing would be written off, the debt would be extinguished, and they were fearful of the tramways being presented to the next generation. Perhaps some of our Scotch friends can tell us what has happened in that respect. Mr. Howitt’s idea of the balance sheet giving only floating assets is a novel one, but as a fact a banker or other person lending to-day would actually make such a calculation, leaving him to form his own ideas as to the value of a mill. True depreciation is an important factor in costing, and there is much to be said for it, and the fact that a manufacturer should at least quote with his eyes open if he is getting an unprofitable price. (Applause.)

MR. F. WOOLLEY, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord

President, ladies and gentlemen, I think there will be no difference of opinion whatever in this Congress on the proposition that charge for depreciation and obsolescence should be made to revenue account, quite irrespective of what the trading results of the year under review may be. There is an occasional tendency on the part of those responsible for the drafting of accounts to accommodate the rate of depreciation to the circumstances of the year, but such a method is fraught with obvious dangers which the auditors will always do well strongly to advise against.

I have been very interested indeed in the reviews in both the papers that are before us as to the various methods adopted in this country and in the United States of America. In some ways, I am bound to say, that the methods applied in the States appear to me to offer useful propositions for consideration here, and although certain methods have become more or less well-established in this country it by no means follows that use should exclude consideration of any better methods. But I would like to stress this: that method is one thing which is very largely open to the particular preference of those immediately concerned; adequacy is quite another thing; and whatever the method adopted may be, that is a more or less immaterial matter upon which there can be room for legitimate difference of opinion, but there can be no room for difference of opinion that what is written off should be adequate. The trouble arises when we ask the question, what is adequate? Obviously the auditor cannot determine this matter, at any rate on his own responsibility. Rates of depreciation are too often fixed in a purely arbitrary manner without a sufficiently careful study of the nature of the items dealt with, and without a sufficiently careful contemplation of what the future history of those items is likely to be. The auditor, it seems to me, would be well advised always to consult those who are technically responsible, and, if he can possibly manage it, to obtain a written report from those officers setting out the rates of depreciation recommended and the risks therefor. Such a report would be an invaluable document for reference in later years when it could be compared with experience to see how far that experience coincides with the reasons upon which the original rates were based and whether any adjustment is consequently needed, either from accelerated wear and tear or from accelerated obsolescence.

I would like to offer a word or two on the subject of depreciation of buildings. I rather gathered from Mr. Fedde's paper that in the United

States it is the common practice to make specific provision for depreciation in respect, not only of fixed assets generally, but of buildings. That is by no means as common here as it might be. Now that we have reached a stage where industry is being revived, old factories are being scrapped and new factories erected to take their places, it does raise seriously the question of specific provision for depreciation of buildings as distinct from plant. It has been, no doubt, generally borne in mind and this factor taken into account in general reserve account, but inasmuch as any factory is likely to become superseded by newer methods within some given length of time, at any rate, it appears to raise the question that depreciation of buildings should be seriously considered as a specific provision from year to year.

May I express my obligations to the writers of these respective papers to-day for the very great information they afford and the suggestiveness of their points. (Applause.)

COUNCILLOR JOHN McLAREN BIGGAR, F.L.A.A. (President of the London Association of Certified Accountants) (Great Britain) : My Lord President, Mr. Chairman, ladies and gentlemen, it was with great pleasure I found that the authors of both papers had stressed obsolescence, which has followed the realisation that there has been increased progress in scientific development and that scientific development is the greatest form of depreciation of value in any asset. It exceeds the physical deterioration of an asset, and even exceeds the lack of productivity of an old plant. I doubt whether our clients realise the increased pace, and I heartily approve the accountants' advocacy of an increased annual charge. Mr. Fedde rightly directs attention to the serious depreciation of buildings by modern developments. May I emphasise the necessity of attention being given to land and site values, which we have hitherto looked on as the best of securities, and the best security which could be offered for a mortgage. Different countries have their different systems of tenure, but owners of freehold land have always expected increment and only infrequently do we find the problem of depreciation for land values. The increasing mobility of modern transport has smashed values in towns and cities, and the increasing mobility of transport has jeopardised any recent increments which may have taken place. Special buildings which are required by modern large multiple production and commercial organisations are likewise almost dangerous assets, and require rapid depreciation. I favour the straight-line method of depreciation with distinct and separate funds for renewals at increased cost and also

for extensions. I realise that this may appear heresy. It is a true economic fact that the consumer ultimately pays the whole cost, but I fail to see that it is quite fair that the present consumers should not only repay the capital employed on their own behalf but in addition provide capital for a future generation.

In conclusion may I say that economic changes have been rapid but there are indications that they will be more rapid in the immediate future, and it is possible that we shall awaken one morning and find, as Burns, our national poet, puts it, that—

“The best-laid schemes o’ mice and men

Gang aft a-gee.”

(Applause.)

LIEUT.-COLONEL R. C. L. THOMAS, M.C., F.S.A.A. (Great Britain) :
Mr. Chairman, my Lord President, ladies and gentlemen, it is undesirable at an International Congress to deal with the local aspect of the subject under discussion, but coming as I do from the district known as the South Wales and Monmouthshire Coalfields, where I suppose the effects of the trade depression have been felt and are being felt as much as anywhere, I have been deeply interested in all that is contained in the papers and has been said by previous speakers on the matter of depression and obsolescence, inasmuch as in the area to which I have previously referred, one of the main industries is that of iron and steel, where the developments in the machinery used in manufacture have undergone such sweeping changes in recent times; principally on the lines of displacing man-power by means of improved types of machinery; compelling manufacturers to make changes in their plant, thus creating a problem of dealing with the obsolescence connected with the displaced machines and involving huge sums of money. The whole problem of depreciation and obsolescence has been so fully dealt with in the papers that I do not want to dwell on the various methods of dealing with it in the accounts of any particular concern, but one cannot help mentioning the established fact from an accountant’s point of view, which is that obsolete and disused plant cannot correctly stand in any balance sheet in excess of its scrap value. This is emphasised in a number of places in the papers under discussion.

The huge sums involved in this connection in certain steel manufacturing concerns make the obsolescence problem one that can only be dealt with by capital reorganisation schemes of a drastic nature, to bring the before-mentioned established fact into operation. It must not be

overlooked that the problem is an ever present one, to undertakings which work on a smaller scale, but the same difficulty is encountered whether the business is large or small, namely, that of providing the cash necessary to lay out the new plant, in the depressed area of the South Wales and Monmouthshire Coalfields, where obsolescence in certain cases has had to be dealt with by means of a capital reorganisation scheme, it is by no means easy to finance any new requirements, even though the asset values have been dealt with more or less on the appraisals method and written down to what should represent their present worth.

I venture to suggest that no country can expect a return to general prosperity until the depressed areas have thrown off their depression by means of a return to active working conditions on a remunerative basis, which state of affairs I am sure everyone within this Congress is anxiously awaiting.

Mr. Howitt, in his paper, when mentioning the obsolescence allowance for income-tax agreed by the English income-tax authorities, did not include a reference to the more generous interpretation made of the regulations by the Board of Inland Revenue some twelve or eighteen months ago. I refer to the arrangements now in force whereby relief is granted where the same type of asset is replaced but not necessarily identically as was formerly insisted upon. That is to say, for example, steam plant replaced by electrical and horse-drawn vehicles replaced by motors; a number of other examples will readily occur. This taxation concession was a very welcome one to traders of all classes, and no doubt is helping in some measure to stimulate improvements and thereby trade in general.

I am grateful to you, Mr. Chairman, and to the members of the Congress for allowing me to make this modest contribution to the discussion on the papers which so adequately set out the whole subject. (Applause.)

MR. P. H. BLACKWELL, F.C.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, I have had the privilege of reading Mr. Howitt's paper, both in an earlier edition and in print, and I should like to thank him for the interest and the instruction I have derived from it. I looked for clear and scholarly treatment of the subject by him, and I was not disappointed.

I noticed in Professor Annan's paper, which was discussed on Wednesday, a passage which is complementary to one of Mr. Howitt's. In considering the reducing balance percentage method Mr. Howitt remarks on the disadvantages attending this method. He points out that one of

these disadvantages is that assets tend to be dealt with in groups, so that some portion of the cost of an asset may be left in capital long after the asset has been scrapped. Mr. Howitt goes on to point out the remedy, which is the careful maintenance of plant registers. This point was taken by Professor Annan at page 273 of his paper. I venture to emphasise it again here, although I am bound to confess that it is not a complete remedy. Even where a plant register is apparently well kept it is sometimes found that plant still figuring in that register is disused and virtually abandoned, without any record of the fact in the books. It may be that the auditor should put a specific question to the works' manager at each audit to ensure that such abandonment is recorded and the plant register kept up to date in respect of casualties of all kinds.

There is a point on which perhaps Mr. Howitt could enlarge if he has the opportunity in replying to the discussion on this paper. Mr. Howitt reminds us on page 643 that, in connection with the balance sheet, the auditor is not a valuer. But on the previous page he reminds us that in reviewing the revenue account, the auditor must be satisfied that reasonable depreciation has been provided for the year. Now if an asset is liable to depreciation, the value at which that asset is taken in the balance sheet must depend on the provision made for that depreciation, and the rate at which provision for depreciation is made is fixed by those in control of the undertaking. The auditor on the other hand has, from his experience, general ideas as to the rates of depreciation to be applied to certain classes of assets. If his idea in a particular instance differs from that of the directors, he may be in a dilemma. Is he not posing as a valuer if he presses his view that the rate of depreciation should be higher than that proposed? I know that usually in such cases much can be effected by persuasion, but I should be glad to have Mr. Howitt's guidance for use in the instances where there is a direct and definite conflict of opinion.

There is a point of nomenclature which arises out of paragraph (b), (i) on page 627. Mr. Howitt speaks of a sinking fund and goes on to say that interest earned is added to the provision, if the sums set aside are separately invested. I have always thought that it would be an advantage if any title which included the word "fund" could be reserved exclusively for the provision of sums which are so invested outside the business, using a term which does not include the word "fund" when the sums set aside are retained in the business. This is indeed Mr. Howitt's view, as appears from a phrase on page 630.

The task of the auditor would be rendered easier if certain of Mr.

Howitt's words on page 637 could be taken to heart by some of our clients. There is no justification, says Mr. Howitt, for regarding depreciation as a mere book-entry. "Even if no profits are available"—and this is what I should like to be drummed into the clients I have in mind—"even if no profits are available, depreciation should be charged and added to the loss." And yet every day chairmen of companies, in dealing with the results of the year, proudly tell the shareholders that the figure is so and so "after providing so many thousands of pounds for depreciation."

To those who are not familiar with it, the note of American income-tax allowances on page 635 is of particular interest. The fixing of the obsolescence rate there must, however, present some interesting problems, for it would appear necessary to forecast the time which will elapse before a new invention renders out of date plant at present efficient.

May I, in conclusion, thank you for listening to me, and thank Mr. Howitt for his most interesting paper. (Applause.)

MR. W. H. CHANTREY, F.C.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, the papers on this subject by Mr. Howitt and Mr. Fedde are very comprehensive and constitute a valuable addition to the literature which has been written on this subject, and the thanks of all are due to these gentlemen for what they have done. The papers cover practically the whole ground, but I would like to emphasise one or two points.

The hypothesis that depreciation is in effect a distribution or spreading of capital outlay over the effective life of the asset is particularly interesting, and to some extent such an asset might be compared with the usually small item in the balance sheet representing rates, insurance and other outgoings paid in advance. The continuance of the business is a necessary assumption to justify the figures at which these assets are included in the balance sheet, and steps might well be taken to impress this point of view upon shareholders and others for whose benefit the balance sheets are prepared or those who are interested in balance sheets.

Of the various methods of depreciation, I would suggest that in the case of a complete and self-contained asset, such as a lease, the annuity method is most suitable, because it takes into account the interest earned on the amounts annually set aside out of the profits. For assets, part of which are being renewed from time to time, such as plant and machinery, the reducing balance method is probably most suitable, because in addition to the fact that the largest depreciation occurs in the first few years, there is also the fact that repairs chargeable to revenue are probably

smaller in those first years, and thus in some measure the charge to revenue is equalised. In view of the many methods of depreciating fixed assets, each of which is fairly well defined, it would be informative if the particular method adopted by a public company or other body were disclosed in the annual accounts and reports. It will not infrequently happen in the case of an old-established business that the annual sums written off for depreciation will have reduced the capital asset to a point below its unexpired value, be it plant, machinery, or equipment, or even a lease. In these circumstances the amount charged to revenue in pursuance of the prescribed methods, will be less than the *pro rata* annual reduction in value, and this will continue until the asset has been exhausted and/or renewed. This position is perhaps not so important so long as a balance sheet is published showing, as Mr. Howitt advocates, the original cost of the asset and the total amount written off, because the relation between the amount written off and the total cost of the asset will be apparent. Nevertheless, Mr. Howitt is of opinion that an auditor should qualify his report if he is not satisfied that reasonable depreciation has been provided for the year.

In his paper Mr. Howitt refers to an auditor's report on past profits for prospectus purposes and the need for having regard to the new capital structure. If the assets have been changed or renewed from time to time during the period covered by the auditor's report on the accounts, then it may be impracticable to reconcile the value of the assets for each of the periods with the new valuation, and it may, therefore, be desirable or even necessary to give the profits before charging depreciation, and to set out the proper amount of future annual depreciation based upon the new valuation and the new capitalisation of the company. The point that I wish to emphasise is the desirability of different treatment of depreciation in the case of the annual accounts of a going concern and a certificate in a prospectus probably covering several years. (Applause.)

MR. E. H. BRIDGEWATER, F.L.A.A. (Great Britain): Mr. Chairman, my Lord President, ladies and gentlemen, in the reading of these papers and the discussions thereon, I have found much instruction and stimulation of thought on the subject under discussion, but it would be presumption on my part to attempt to put forward from this platform the points that they have raised in the mind of one who is still only a student of the problems the subject presents, especially in the presence of the authors of most of the writings from which I gathered such knowledge of the theory of the subject as I may possess. Therefore I do not

propose to suggest the questions and theories occurring to me, which have no doubt been thoroughly explored by those whose experience and practical knowledge make them so much more competent to speak on these problems with real authority.

But there is one point upon which I feel that I can speak, and that is the importance of proper provision for depreciation and obsolescence by the small business man carrying on his business either as a sole trader or a comparatively small private limited company. This type of business does not give rise to the complicated problems that arise in the affairs of large public companies, but nevertheless I am convinced that the basic reason for the failure of many such businesses is the absence of careful consideration of the effect of these two factors upon the real solidity of the business.

I think most accountants will agree that it is usually very difficult to persuade the average man that his fixed assets are decreasing in value or likely to become out of date. He may agree on general lines that it possibly is so decreasing, but that is very different from agreeing to leave some of his apparent profits in the business to meet the loss so incurred. It is only when he finds himself unable to replace an asset which is no longer of use, or requires to borrow money and finds that his assets are no longer a sufficient cover, that he realises the advisability of proper provision for a loss which is taking place all the time, and by that time it is too late.

In a large concern these questions are well understood and can be ventilated and discussed with technical officers who thoroughly understand the capabilities of the asset concerned, and are well versed in the progress being made with ideas and designs that are likely to affect its earning capacity, but in the smaller business the accountant is often in considerable difficulty. In many cases he is, in fact, if not in law, responsible for the form of the accounts, and in his endeavours to follow conservative accounting principles he may easily run counter to the ideas of the owner of the business whose main concern is present profits. With a limited company, however small, we do find some support from the requirements of the Companies Acts, but with firms and sole traders there is nothing to give such support.

Now both writers of the papers before us to-day lay emphasis on the effect of income-tax regulations on accounting policy, and although I have no experience of American accounting, yet I can fully appreciate the effect of such regulations in Great Britain. Only when discussing tax

liability is the client really inclined to agree that there has been depreciation, and then we have to tell him that in any case it will not be allowed, but an allowance will be made in respect of wear and tear, which allowance is usually quite inadequate ; which only applies to certain classes of assets, and the rate of which has probably been fixed comparatively arbitrarily by the local Commissioners some years before. Who can blame the accountant if, instructed by one Act of Parliament to satisfy himself that proper provision has been made for depreciation in the accounts that he audits, and yet informed by another Act of Parliament that allowance will probably be restricted to an arbitrary figure, he contents himself with seeing that the accounts are as far as possible in line with the income-tax regulations.

The American tax law is apparently in advance of ours in that it recognises, not only actual depreciation, but also includes under that term a reasonable allowance each year in respect of obsolescence, and, as Mr. Howitt says, this must undoubtedly encourage a more prudent policy in accounting, as the question of obsolescence is forced to the attention of the business man each year, whereas we have to wait until the contingency has materialised. I am not suggesting by these remarks that merely to incorporate a yearly allowance for obsolescence in the British income-tax code would automatically prevent small businesses from going bankrupt, but it is in my mind that we have here to-day the eminent leaders of our profession who are consulted in many ways in connection with Governmental decrees, and as a humble member of the rank and file, I would suggest to them that whenever they can use their influence in any way to strengthen the legal consideration given to these questions, in such ways as bringing it more prominently into the taxing code, they will be helping to bring them more urgently before the general business community. At the same time they will be giving other accountants considerable assistance in their endeavours to persuade the business world to give due thought to an item that is the more dangerous in that its immediate effect is not obvious, and thus assisting in part in avoiding one of the largest pitfalls that open out before small businesses, which, after all, in total, play a considerable part in the affairs of any nation. (Applause.)

MR. W. NORMAN BUBB, F.S.A.A. (Great Britain) : Mr. Chairman, my Lord President, ladies and gentlemen, no one who has had the opportunity of reading through the two papers submitted to the Congress this afternoon can fail to have been struck by the similarity in views expressed by Mr. Howitt and Mr. Fedde in their respective papers—the former acting

as spokesman for the profession in Great Britain, and the latter for the profession in the United States of America. This, to my mind, is evidence of the recognition on both sides of the water of the same underlying principles, generally speaking, upon which accountancy practice is based so far as it relates to the particular subject under consideration this afternoon, namely, depreciation and obsolescence, and the views expressed will undoubtedly be accepted as "common ground" to the profession.

Depreciation is admittedly one of the most important and at the same time one of the most difficult of all accountancy considerations. Both authors have pointed out that depreciation is as much a charge in accounts as is any other item of expenditure, and that it is *not* an appropriation to be provided only when profits are available. Too great emphasis cannot be laid on this important fact, and was referred to by Mr. Woolley. Depreciation from an accountant's standpoint has been defined as the "measure of the exhaustion of effective life of an asset due either to use or to obsolescence"—the problem of depreciation being to provide for that eventual loss as it accrues—the effective life of an asset being naturally affected by questions of upkeep and renewal. It has also been emphasised that in these days the factor of obsolescence is frequently more important than that of wear and tear.

I do not propose to refer in detail to the various methods of calculating depreciation placed before us in the two papers, except to observe that the "reducing balance" method seems to find more favour in the United States. The latter method is, in my opinion, the simpler one to adopt as it renders unnecessary the keeping of a plant register. I agree with the view expressed that there is more to be said for a broad and prudent policy in these matters than for one limited to the exact writing off of past expenditure in a pre-determined way.

In his role as financial adviser, an accountant is constantly making contracts with directors and proprietors who do not always appreciate to quite the same degree as does an accountant, the theoretical aspects of the question. His clients will agree that a machine wears out or depreciates in value and that provision must be made for this wastage. They will want to know:—(i) How to deal with the depreciation of a machine or other asset, and (ii) The effect depreciation has on the profits. The accountant will be provided with the material facts, such as the probable life of the machine, and he will then be asked to show the financial aspect of the position. In the majority of cases, directors and proprietors will prefer, if possible, to have a charge for depreciation that

is "constant," in order that they may have a definite figure to include in their future budgets or costings. It is "up to" the accountant, then, to do his best to stabilise this charge over a number of years. To effect this result it is almost impossible to utilise the "reducing balance" method and the "straight line" method therefore commends itself. Arguments as to increasing cost of repairs as the machine becomes worn out may be used against the adoption of the latter method. The accountant may perhaps be faced with a criticism from the directors that the rate suggested by him is too heavy in view of the fact that the Inland Revenue allows a smaller and reducing amount each year. This retort has come up time after time in the experience of us all in this country and is evidence of an ingrained notion in the mind of the average director that the amounts allowed for wear and tear (depreciation) by the Inland Revenue authorities represent the correct or even the maximum amounts to charge.

In his speech at the annual meeting of one of the great shipping companies recently, the chairman stated that the depreciation written off in past years was greater than the amount allowed by the Inland Revenue and made this fact an excuse for a smaller allocation to depreciation reserve in the current year.

Mr. Fedde drew attention to the tendency in the United States a few years ago, in view of increased values for corporations to revise the values of their fixed assets and their depreciation charges. This tendency which is not altogether unknown in this country, would not be open to so much objection provided the increased values were permanent. Events in both countries have proved, alas, that in this changing world there is no certainty or stability about values. It is interesting to learn that in the United States a greater interest is now being taken in the methods of presenting company accounts and reports and that recommendations on the part of the New York Stock Exchange have already been issued urging that disclosure should be made by corporations when any change occurs in the basis of their property valuations or depreciation policy. This is a step in the right direction and one which might with advantage be followed here.

It is, of course, well known that in this country the published accounts of some of our largest concerns contain the minimum of information, the reason advanced for this being the fear of disclosing vital information to competitors.

I agree with the view expressed that in the case of a limited company

it is due to the shareholders to be informed, at least, when any change in method is adopted in regard to writing off depreciation. The following case may be of interest : A public company whose business was adversely affected by recent legislation, found its turnover and profits declining. The management accordingly looked round to see where economies could be effected, but little success resulted from the search. Then "paper" economies were looked for. The company's auditors had for years previously recommended, and secured the director's agreement to the writing off of depreciation of one of the company's assets over five years by the "straight line" method with the result that the asset in question stood at a very low figure. The directors accordingly felt justified in omitting any charge for depreciation of that particular asset in the year's accounts, with the result that the profits shown were considerably larger than they otherwise would have been. The point I wish to stress is that in the published accounts of that company no mention was made as to any departure from the usual method of providing for depreciation.

Mr. Howitt has drawn attention to the existence of the view held by some, that, legally, depreciation need not be made good before distributing the surplus of income over expenditure. He has taken pains, however, to emphasise that the English courts have never laid down that the excess of revenue receipts over expenditure can properly be distributed in dividend before providing for wear and tear of fixed assets during the accounting period. It is interesting to note that in the two cases referred to by him the Court expresses the contrary view. On the other hand, the legal decisions in the cases of *Verner v. The General Commercial Investment Trust* and *Ammonia Soda Company* support the view that losses of fixed capital (such as obsolescence and arrears of past depreciation) may be disregarded in ascertaining distributable profits.

In spite of the great measure of agreement already reached on this important subject, I feel that a great deal still remains to be done in the direction of "educating" our clients to a due appreciation of the need for an adequate charge under the head of depreciation, for, as has been pointed out, depreciation in the case of fixed assets is taking place all the time, regardless of fluctuations in costs, and all fixed assets (with few exceptions) must sooner or later be scrapped.

In concluding my observations, I do not think I can do better than recall to your mind some of the remarks made at the Banquet in the Guildhall on Wednesday. Both the President of the Congress and the President of the previous Congress referred to the functions of account-

ants, Lord Plender very properly emphasising that it was the duty of the accountant at all times to state facts, whilst Colonel Montgomery stressed that it was incumbent upon the accountant, on all occasions, to state "the truth, the whole truth and nothing but the truth." I submit that these remarks are as aptly applicable to the present subject under discussion as to those subjects which have preceded it at this Congress and my purpose in drawing attention thereto is because the particular features referred to do not always receive the same measure of serious attention which is given to other accountancy problems.

We have heard a great deal this morning and during the Congress about statutory obligations, and quite rightly too, but in carrying out one's duties one should always endeavour to act up to the spirit, rather than the letter; or both if you like, so long as the former is uppermost in one's mind. (Applause.)

MR. H. G. HOWITT: Mr. Chairman, my Lord President, ladies and gentlemen, I am very grateful for the kindly reception—and I am sure Mr. Fedde agrees with me—which has been given to the papers we have delivered. In particular I am grateful to Mr. Wetherall for the remarks he made on my paper in opening the discussion. I expected I should be taken to task by someone—and he did it—for having launched into poetry, and I am somewhat relieved at the way I have been let off. I was, in fact, afraid he might have tackled me on another point, namely, that in adopting that particular quotation I was presuming to liken this Fourth International Congress to an "insubstantial pageant." I had no such thought in mind, and I am quite sure Shakespeare was not referring to a body of this kind, or he would not have dared to use that expression.

The problem we are up against is this: With the limitations which we know to exist in regard to published accounts how can we best deal with the great problem of fixed assets? The conclusion that I came to—and I think it is the conclusion of Mr. Fedde and of this meeting—is that whilst we must emphasise that we are not valuers, we have a definite contribution to make to the problem, namely, we should insist that the charge which is made for the period whose accounts we are auditing is reasonable, so that earning capacity shall be shown as correctly as possible. I doubt if we can go very much further than that. The balance sheet value that is left representing the fixed assets may be either too much or too little. If it is too much, as compared with the real value of the assets, the reason may be that revenue in these days cannot always keep

pace with the demands of obsolescence. There is a point beyond which revenue cannot meet that position, and reconstruction may be the only alternative. On the other hand, it may be that, due to changing conditions, to increase in values, or currency alterations, fixed asset values are understated. This represents a form of secret reserve with which as auditors I suggest we cannot be expected to deal. It is also a form of secret reserve which it is almost impossible to codify or to deal with by legislation.

The next point that Mr. Wetherall dealt with was this: He said it was a paradox of accounting that there was nothing with which to write off when profits were not there. That, again, strikes a fundamental point and I should like to reply to it by quoting another paradox, which occurred to me whilst he was speaking. It is the paradox that fixed assets are really a form of liability. I want to be careful and qualify that statement. I mean that if you own fixed assets for the purpose of a continuing trade you have the alternative either to go out of business or to provide for their renewal. Therefore I do not think that provision for depreciation has anything to do with profits. It is something that you should provide for as an operating cost, whether you have profits or not.

Mr. Wetherall then mentioned the question of the load factor. He suggested that depreciation might be calculated on the load factor of machines, meaning, I suppose, that if in any given period machines were not worked to full capacity depreciation for that period should be correspondingly reduced. I think there is a great deal in that, but if you adopt that principle you must have some kind of minimum, otherwise in times of depression you get far too low a depreciation charge, even to cover the wear and tear that must have taken place. You can work out such a policy perfectly easily in times of good trade, but in these uncertain days we cannot be sure that good times are ahead within the lifetime of an asset and therefore, as a matter of prudence, an annual minimum charge should always be made.

The last point that Mr. Wetherall made was with reference to the sinking-fund method. I was rather glad when I heard him speak that I had mentioned that the sinking-fund method was particularly applicable to public utility concerns because I understand that that is the kind of concern in which he is primarily interested. The fact remains that the sinking-fund method, and, I am bound to say, the investment of reserves outside the business which is usually associated with this method, is not often used in commercial businesses.

I think I ought to leave Professor Hatfield to Mr. Fedde, but in substance the reply I make to him is this : You remember he was very anxious that we should define a policy and stick to it and determine what were our principles—whether as a profession we were going to advocate this method or that method, this policy or that policy. I think that would be all right if we could be satisfied that over a period there would be always a definite relationship between capital and revenue, but we cannot be certain of that, and therefore we cannot in advance lay down definite and final rules. We can, however, suggest, as I have in my paper, certain principles, e.g. that for costing purposes a manufacturer should have regard to replacement costs and not merely to original costs. We ought to leave a certain amount to the policy and discretion of the board of directors. It is for them to say what policy they intend to pursue—do they wish the business to continue as such or do they wish to get the most out of it, as in the case of some mines, which include with their annual dividends an element which is admittedly of a capital nature. These are matters which ought to be left to the discretion of the company. The point is that whatever policy is decided upon should be declared, so that in looking at the published accounts one would know what the depreciation charge purports to represent, and if the policy is changed it ought to be definitely announced.

Mr. Leake was the next speaker. We are all grateful to him for any observations that he has to make on depreciation. I am bound to say, however, that to my mind the effect of putting aside a reserve in the form of depreciation does mean that the business as such has put aside capital which is invested in the business and is therefore available for earning profits or interest, whichever way we like to put it, and therefore, both the straight line method and the reducing-balance method have, in effect, over the period of their operation, provided an element of interest, in that they have provided the business with working capital. Therefore, in the later years of the operation of those two methods the annual charge is, in effect, very largely a matter of interest, and not wear and tear provision. In fact, if there is a high rate of depreciation at work in the later years the depreciation charge becomes a negative figure, the interest charge providing more than the annual requirement.

Mr. Leake also mentioned the question of goodwill. I am not going to launch into discussion of that question. The essential point is this, that goodwill is something that you have paid for, rightly or wrongly,

there it is ; it does not carry with it any obligation and is entirely different from bricks and mortar in that respect. Bricks and mortar carry an obligation ; they have to be renewed, and therefore reserve has to be made for them. Goodwill has not to be renewed. If it is not worth what was paid for it, that is the end of the matter.

Mr. Pelsler advocated a third method of depreciation. He said that in certain instances the depreciation charge might be dependent on the amount of profits available. My main criticism of that new position is although it may be prudent from the balance sheet point of view to write off as much as you can when you have profits available (surplus to what you have charged in your ordinary working account) it would be only a book entry—putting the balance sheet in a more stable position, provided you keep the reserve in hand and do not distribute it. It adds nothing however, towards stating the true earning capacity over a series of years, and that is the great point at which we ought to aim. I think the other answer is, that if one admitted that principle one would find it very difficult to refute the converse contention, which would be put to us, namely, that in times of bad profits or of losses there was no need to make any provision. We must stand firm, I think, and resist that alternative suggestion.

I am grateful to my friend Mr. Carter for any remark that he makes on this subject, and particularly when he speaks on income-tax matters, on which he is such an expert. Anyone who has had discussions with the income-tax authorities must realise the great difficulties there are in estimating what is and what is not a fair rate of depreciation. These problems are taken to the Inland Revenue authorities and discussed by bodies of traders. You will then find, if you have occasion to represent them, that there is a mass of information in the revenue office from which they can argue if necessary that certain assets hardly disappear at all. Railway wagons for instance : In certain cases the sides may have been renewed one year, the buffers the next year, and the wheels another year and the wagon as a wagon probably never disappeared altogether. And so in discussing such problems one has to consider the very varied nature of each asset that one is dealing with, because some of them—wagons, for instance—are like old soldiers ; they never die—and they never even seem to fade away.

Mr. Woolley and Mr. Biggar both mentioned the question of buildings, and Mr. Biggar advocated that more depreciation ought to be provided. In that I thoroughly agree with him. It is one of the criticisms I should

like to make about income-tax practice, because the absence of depreciation on buildings in some annual accounts is probably encouraged by the fact that there is no direct tax allowance in respect of them.

Mr. Blackwell put to me a question rather on the same point—as to what rate of depreciation the auditor should suggest when he has a dispute with a board of directors. If he has to admit he has no expert or special knowledge of the trade in question I am bound to say that the only thing he can act on is the income-tax rate. We know they are modest rates, and therefore at best they represent in our minds a minimum of what ought to be provided. At any rate, we can urge the income-tax scale with assurance, and if we get that minimum things will not go very far wrong.

Mr. Chantrey mentioned the question of prospectuses. There I would emphasise that in giving a review of earning capacity over a 5-year period it may be necessary to calculate depreciation on quite a different basis from that adopted in the annual accounts under review. It may be necessary to have in mind the altered capital structure of the new organisation. It may be that the prospectus formula represents one of the future solutions for dealing with this fixed asset problem, namely, that it may come to pass that even in submitting the annual accounts of companies it will become the custom to submit some kind of review over a past period of years, prepared on a uniform basis. Such a review, if it were brought about, would give, to my mind, the best indication possible from year to year as to what is the true value of the fixed assets and of the undertaking as a whole.

I think I have dealt with all the points, except that the Chairman in opening said—and I would like to endorse his view—that it is perhaps appropriate that the last meeting of the Congress should be the one to discuss the question of depreciation. We can at least apply our own particular theories to our own case and see whether the wear and tear we have suffered during the week works out so that our residual value is left at what it ought to be. I hope in our case, although we may have suffered wear and tear throughout the week, the obsolescence factor is not too great—indeed I hope there is a credit, in that our usefulness for our daily work may have been improved, and in that our unexpired period of effective life may have been extended and not reduced. I hope at any rate that we have enough residual value left to enjoy the Ball in this Hall to-night. (Laughter and applause.)

MR. FEDDE: My Lord President, Mr. Chairman, gentlemen, as I

watched Mr. Howitt taking copious notes, I foresaw that his summary would be comprehensive, as it proved to be.

The hour being late, I shall therefore not review the same matter again, but close very briefly, though unable to do so with the felicitous three-word benediction as recently uttered by his Grace the Archbishop of York at our Banquet.

I was on the platform of the last session of the Congress held in Amsterdam in 1926, and now am on the platform of this Congress at its close. This, happily, gives me the opportunity to congratulate the sponsors of this Congress on the marvellous way in which it has been planned and carried through, and to thank them most heartily for the way they have entertained and looked after us. If London invites us again some time in the future, I am sure we all will come again.

[The following notes were also handed in, but through lack of time the speech could not be delivered.]

MR. F. R. M. DE PAULA, O.B.E., F.C.A. (Great Britain) : From the point of view of industry, this subject is obviously of vital importance in view of the enormous growth in the proportion of the capital invested in industry that is represented by fixed assets and also the constant development and improvement in industrial plant.

In my view it is most desirable that there should be uniformity of method. In any particular industry, if different methods are adopted in calculating depreciation, this vitally affects costs. The importance of this is illustrated by the fact that in the case of companies with which I am familiar, depreciation represents 100 per cent. on direct labour and therefore the adoption of different methods of calculation of depreciation must make a very material difference to costs.

If different manufacturers in a particular industry all calculate their costs in a different manner, the results may be and in many cases are very detrimental to the industry as a whole. In the papers under consideration, eight different methods for writing off depreciation are described and the pros and cons of each method have been carefully explained.

In the course of the discussion it is clear that certain members of the audience have decided views in favour of one or other of these methods. In his paper, Mr. Howitt stated that the main objects of depreciation charges were to "arrive at a correct statement of yearly revenue" and "to maintain a correct costing record." These various methods give widely different results and if this position is correct it would be possible for a business for any one year to prepare eight profit and loss accounts,

each showing a different result and yet it is argued that this is correct.

Personally, I cannot accept this and I would liken this situation to an engineer who is designing a bridge and wishing to calculate the strains and stresses referred to his textbook and found that there were eight different methods by which he could make the calculation and each one gave different results. I think in these circumstances many of us would hesitate before we took a heavy load across that bridge.

The answer to this particular point which the profession gives, I gather from the discussion, is that the selection of method depends upon circumstances. When we say this, in my opinion we are running away from the responsibility of making up our minds. American accountants have made up their minds in favour of the straight-line method but I do not accept Mr. Fedde's contention that conditions in that country are different from those in this country. Here, although we all have our individual opinions, collectively we have not made up our minds.

There must, I suggest, be one sound principle governing a matter such as this and it seems to me a matter of the greatest importance that we, as a profession, should establish our principle as to this and several other fundamental matters of accounting upon which also we have not made up our minds.

I do not think that it is surprising that we have not collectively made up our minds, for our profession has grown with such remarkable rapidity, we have all been so deeply engaged upon our day-to-day tasks that collectively the profession has not had time to pause, think these matters out and make up its mind.

The older professions have settled their fundamental principles largely by establishing a scientific side by means of professorships, research work, &c. Our profession, it seems to me, has hardly started to create and cultivate its scientific side. For example, in the University of London, there is no Chair of Accountancy. There was one, and its first distinguished occupant was my friend the late Professor Dicksee, and I had the honour to follow him, but when I retired the Academic Authorities required the Chair for another purpose, with the result that the Chair of Accountancy was quietly put to death and it passed unnoticed, so far as I can judge, by our profession.

I am strongly of opinion that our profession has reached the stage when we should commence to establish our principles, and one valuable step in this direction would be for the profession to found Chairs at Universities, take a direct interest in research work and encourage writing.

There is in my view a big field for research and the result of a scientific study would be of inestimable value to the profession and to industry as a whole. Uniform practice based on sound principles is a goal that we should aim at but which as yet appears to me is a long way off.

THE CHAIRMAN : Mr. Howitt and Mr. Fedde, I am sure the Fourth International Congress on Accounting is grateful to you both for the able papers which you have presented for the discussion which has ensued, and for the replies which you have given. This is the last paper, and now it only remains to have what I believe the Americans would call the concluding exercises. Our President, Lord Plender, occupied the Chair at the opening session ; it is right and proper that he should occupy the Chair at the concluding session. I have therefore much pleasure in vacating the seat to him.

THE PRESIDENT then took the Chair, amid loud applause.

COLONEL ROBERT MONTGOMERY, C.P.A. (United States of America) : My Lord President, ladies and gentlemen, I have the honour to be a member of the American Institute of Accountants, The American Society of Certified Public Accountants, The Society of University Instructors in Accounting, The New York State and other State Societies of Certified Public Accountants. On behalf of those Societies and all other accountants in the United States, including Porto Rico, the Philippine Islands, Canada, Mexico and Paraguay, I wish to express felicitations and thanks to our British hosts. When we received our invitations last year, we expected much. We may be new, but we are very observant. We do not scorn to learn from those who know more than we do, who entertain better than we do. We have ceremonies and traditions. We are still feeling our way and cannot tell at this moment whether you will find a dictator or a constitutional President the next time you come to the United States, which we hope will be in three or four years. We expected much—we have found more—much more than we expected, much more than we deserved. Your arrangements have out-perfected perfection. Your attention to and solicitude for those thousand and one things which make for comfort and happiness, have been boundless. Your Executive Secretary, Mr. Colville, has been constant in his care, unlimited in his courtesy ; his staff of charming young ladies have made it difficult to decide where we should spend our time—in the office or in the skating rink. Your Executive Committee have looked after us as we have never been looked after before. The members at large of your sponsoring societies have

made us happy in many different ways.

And you, my Lord Plender, have led all the rest, and to you, and through you, we offer our heartiest congratulations and our heartfelt respect, admiration and gratitude for the honour of participating in this best of all International Congresses. (Applause.) My Lord President, my friend, Mr. Van Dien tells me that I have just made a motion, and I therefore propose what I have just said as a resolution. (Cheers and loud applause.)

MONS. E. VAN DIEN, F.S.A.A. (Holland) : My Lord President, ladies and gentlemen, I am most happy to second Colonel Montgomery's motion, or resolution, or whatever he wants to call it, on behalf of all the Continental accountants here present. I am not a member of so many societies as my friend Colonel Montgomery. Nevertheless I want to speak in the name of our colleagues in Africa, Australia, Austria, China, Czechoslovakia, Denmark, France, Germany, Holland, Japan, Italy, Norway, Poland, Roumania, Sweden, Switzerland—and their ladies too. (Laughter and applause.) Time will, of course, not allow the delegates from all the different countries to express their feelings towards our hosts. This Congress proves once more that every generation stands on the shoulders of its predecessors. St. Louis 1904 was a very nice start, Amsterdam 1926 was perhaps a little better—and it should be, as we took 22 years to practice—then New York 1929 was a revelation to us all in regard to what could be done with many hundreds of us, dry accountants, and now London 1933, is, in my opinion, the acme of what can be done to entertain and to give scientific information to so many accountants gathered from so many different countries from all parts of the world. And I sympathise with my Italian friends, who are undertaking to entertain international accountants in Rome in 1936, for being compelled to compete with this reception.

For those who have not been in the kitchen of such big gatherings it is impossible to realise what a tremendous lot of work has to be done before we, the guests, are allowed to arrive. The Secretary of this Conference, the Honourable George Colville, showed me some time ago when I was in his office in London the preparations he had made to receive the delegates, which were all devised to be sure that no name should be forgotten and that no wish of any visitor should be neglected. I am very sorry to say here that I was not able to make any suggestion as to what alterations could be made to complete his books and papers. The only thing I could say was: "It is marvellous." Not only the

Honourable George Colville, but his assistant Secretaries, Messrs. Bankes and Garrett, are entitled to the gratitude of the delegates and visitors for the silent but very serious work they have done on our behalf, (Applause.) We must not forget in this connection the young ladies in the office here, who have done so much to make life worth living for us. (Hear, hear.)

Et finalement, pour être sûr que notre reconnaissance sera exprimée dans une langue comprise par ceux de nos collègues qui ne comprennent pas suffisamment l'Anglais, j'ajoute que tous nous vous remercions de tout notre coeur pour tout ce que vous avez fait pour nous pendant cette semaine inoubliable.

In conclusion I might say that from the Lord President of this Congress to the youngest clerk in the office here everyone did everything to make this Congress a success, and it will long remain a glorious example of what British taste, British knowledge and British hospitality can bring together. I am most happy to second Colonel Montgomery's motion. (Applause.)

COLONEL MONTGOMERY: Ladies and Gentlemen, you have heard the motion. All those in favour will please say "Aye." (Shouts of "Aye!") My Lord President, the motion is unanimously carried. (Applause.)

THE PRESIDENT, who was enthusiastically received, said: Colonel Montgomery, Mr. Van Dien, ladies and gentlemen, I have listened, as my many friends who are your hosts at this Congress have listened, with much appreciation to the kind words of thanks used by Colonel Montgomery and Mr. Van Dien on behalf of the delegates and visitors who have honoured us in accepting our invitation, and the warm reception given to the vote of thanks by all of you has touched us deeply.

We have looked forward to this week as an opportunity not only for the interchange of views on practice, and experience in accounting principles and methods, but also as a little repayment of the many kindnesses and courtesies we have received at the three preceding International Congresses in the United States of America and Holland. The week of effort is now ended, the Congress is about to close and we disperse to our respective homes with a feeling, I trust, of fulfilled expectations and of pleasant memories.

I hope there is no feeling on anyone's part that they have been overlooked. It is not easy to take care of everyone where there are so many, but we have tried to make our friends from abroad feel that we are all part of a great brotherhood for mutual help and service, and in our effort I

trust that we have not failed. We have been happy in welcoming and associating with old friends, and we have formed new friendships which will last.

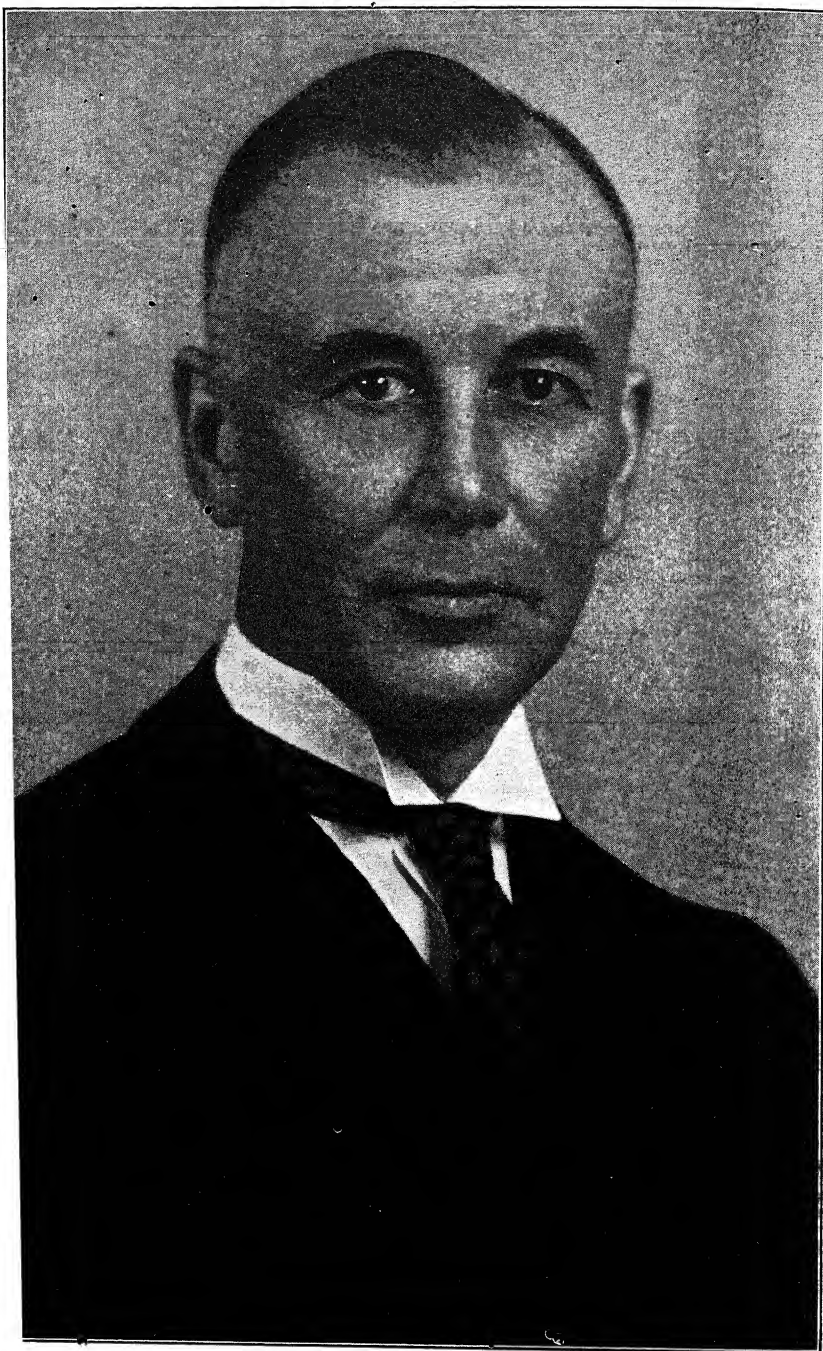
The valuable papers which have been read and discussed should prove of permanent interest to the profession and be most helpful in our practice, and I gladly take this opportunity of thanking, in your name, the distinguished gentlemen who have given us the benefit of their experience, and for the time and trouble they have taken in the preparation of their papers.

The arrangements for this Congress have, I think, been admirable. There are many people whom I would like to mention who have rendered invaluable help and whose efforts for many months past have been unceasing: but to enumerate them all would perhaps take too long a time. They are recorded on page 4 of the programme, and in the official record of the proceedings of the Congress their names will be embodied. But I feel sure you would not like me, as President, to refrain from mentioning specially Mr. Colville, the Secretary, who, with the Assistant Secretaries and their loyal staff have contributed so much to make this Congress an unqualified success, and I may also mention my old friend, Sir James Martin, the Vice-President, who has faithfully supported me always and helped the Executive Committee by his wise guidance and wide experience.

Many of our friends here are already looking forward to another International Congress. We must take care not to suffer from indigestion, and it may be wise to let a sufficiently lengthy period—but not too long—elapse before another Congress is convened. And in this connection I am happy to tell you that I have received a letter dated the 18th inst. from Signor Alfredo Selvi, President of the Italian Delegation, suggesting that the next Congress be held in Rome in 1936, and offering to us with that courtesy and warmheartedness which characterises the people of that great nation, a reception worthy of the event. I am sure that you will permit me, on your behalf, to thank him most cordially for the invitation to a City that we all reverence and whose history is imperishable—and to a country where bookkeeping in a scientific form is said to have originated.

And now comes the time to say farewell. I do so, in the name of the eight sponsoring bodies, with feelings of regret at parting, but with pleasurable anticipation of meeting again. The curtain falls for the present, but it will rise again when re-union takes place. (Applause.)

Monsieur Van Dien called for three cheers for the President; these were given with great heartiness and the Congress terminated.



MR. A. A. GARRETT, F.C.I.S.:

[Photo by Howard Coster

*Joint Assistant Secretary
of the Congress*

TOUR OF LONDON

A second tour of London was arranged for the benefit of ladies accompanying delegates and visitors. This time the route lay westwards, passing Buckingham Palace, Westminster Abbey, Lambeth Palace, the Tate Picture Gallery and other well-known monuments, and returning via Kensington and Hyde Park to Oxford Street. Here several ladies were entertained to tea by Messrs. Peter Robinson, Ltd., but most of the party returned to the Skating Rink at Grosvenor House to hear the closing speeches of the final Congress Session.

BALL

The Congress came to a conclusion with a ball at Grosvenor House, commencing at 10 p.m., when a company of about 900 met in the Skating Rink. Lord and Lady Plender and Sir James and Lady Martin received the guests. The Embassy band provided the music, and supper was served. Although the night was warm, the dancing appeared to be greatly appreciated and continued unabated until 3 a.m. on Saturday morning, when, after the playing of the National Anthem, many visitors joined in singing Auld Lang Syne.

VISIT TO SCOTLAND

Invitations had previously been issued to the delegates to visit Scotland during the week commencing 24th July, and over one hundred delegates and others accepted the invitation. On Monday they were the guests of the Society of Accountants in Edinburgh ; on Tuesday and Wednesday the guests of the Institute of Accountants and Actuaries in Glasgow and the Corporation of Accountants ; and on Thursday and Friday the guests of the Society of Accountants in Aberdeen.

EDINBURGH

Monday's proceedings began with a visit by motor to places of interest in the City, including the Castle and the Palace of Holyrood House. Lunch was served in the North British Station Hotel. Mr. Shiells presided over an attendance of over two hundred, and was supported on his right by the President of the Institute of Chartered Accountants in England and Wales (Mr. H. L. H. Hill), Sir Thomas Whitson, Mr. J. Stuart Gowans and the following delegates : Mons. Marc Barbut, Mr. John F. Forbes, Mons. Seth Svensson, Mons. N. Butculescu, Mr. John Parton ; and on his left by the President of the Institute of Accountants and Actuaries in Glasgow (Sir Thomas Kelly), the President of the Incorporated Society of Accountants and Auditors (Mr. E. Cassleton Elliott), the President of the London Association of Accountants (Mr. John M. Biggar), and the following delegates : Mons. W. T. J. Abbema, Mons. C. Sommerschild, Mons. J. P. Strobel and Mons. K. Augsten. The toast of " The King," proposed by Mr. Shiells, having been duly honoured, Mr. Hill, President of the Institute of Chartered Accountants in England and Wales, in a short speech, thanked the Society of Accountants in Edinburgh for their hospitality. On the motion of Mr. E. Cassleton Elliott, President of the Incorporated Society of Accountants and Auditors, the health of Mr. and Mrs. Shiells was proposed and pledged with acclamation. The proceedings terminated with the singing of " Auld Lang Syne."

In the afternoon the visitors had a motor excursion to Peebles Hydro-pathic, where tea was served.

In the evening the Freemasons' Hall was the scene of a very enjoyable and successful reception. The President and Mrs. Shiells received the guests, of whom there were about 400. A large number of the Society's members resident in Edinburgh, and their wives, were present to extend a further welcome to Edinburgh to the delegates and other visitors who had attended the Congress. The Lord Provost and the Lady Provost; Sir Andrew Grierson, the Town Clerk, and Lady Grierson and many other distinguished representatives of the legal, medical and other professions in Edinburgh were also the guests of the Society on this occasion.

A delightful programme of Scots songs was finely rendered by Mr. John Mathewson, and was much enjoyed by all. Further entertainment was provided by a string quintette, who played selections of music during the evening.

LIST OF FOREIGN DELEGATES AND VISITORS ENTERTAINED BY THE
SOCIETY OF ACCOUNTANTS IN EDINBURGH

Abbema, W. T. J.	Butculescu, Madame Catherine
Augsten, K.	Clark, H. R.
Banks, A. S.	Clark, Mrs.
Banks, Mrs.	Dietze, Frau Eva
Banks, Miss	Douwe, Van
Barbut, Marc.	Douwe, Madame Van
Barbut, Madame Marc.	Douwe, Mdlle.
Bell, Mrs. L. B.	Egnell, Herman
Bès de Berc, René	Elfborg, Kurt
Berg, John	Elliott, E. Cassleton (<i>President of</i>
Berg, Mrs.	<i>the Society of Incorporated Ac-</i>
Biggar, John M. (<i>President of the</i>	<i>countants and Auditors</i>).
<i>London Association of Certified</i>	Fabella, Señor
<i>Accountants</i>).	Fabella, Señora
Bohlin, L. T.	Forberg, Paal
Bohlin, Mdle.	Forberg, Madame
Brates, Dr. Drăgănescu	Forbeș, John F.
Brates, Madame Drăgănescu	Forbes, Mrs.
Breuner, O.	Fuksa, Ing. J.
Breuner, Madame O.	Fuksova-Svata, Frau J.
Buriat, Emile	Garrett, A. A. (<i>Secretary of the</i>
Buriat, Madame E.	<i>Society of Incorporated Account-</i>
Butculescu, N.	<i>ants and Auditors</i>).

- | | |
|---|---------------------------|
| Grahl, Hugo | Parton, Miss |
| Greenhill, Mrs. William | Pearson, Miss |
| Griswold, E. H. | Pelser, J. |
| Gross, Hugo | Pelser-Groenevelt, Madame |
| HaIdane, Mrs. | Penndorf, Professor B. |
| Hamelberg, W. A. | Retail, Léon |
| Hamelberg-Bosch, Madame | Retail, Madame |
| Henderson, Mrs. Kehneth | Rittenhouse, C. F. |
| Hill, H. L. H. (<i>President of the</i> | Rittenhouse, Mrs. |
| <i>Institute of Chartered Accountants</i> | Rittenhouse, Miss |
| <i>in England and Wales</i>). | Robles, Drs. A. |
| Hogeweg, G. P. J. | Schiffman, Dr. W. |
| Holban, Arthur | Schmidt, Fräulein Johanna |
| Holban, Mrs. | Schourp, Dr. Paul |
| Horn, Dr. G. F. * | Schultze, G. |
| Jespersen, C. | Schwoon, Melchior |
| Jespersen, Madame | Sharpe, Mrs. W. W. |
| Judd, Harold G. (<i>Chairman of the</i> | Shiells, Mrs. C. J. |
| <i>Association of Scottish Chartered</i> | Sjoaker, Ture |
| <i>Accountants in London</i>). | Sjoaker, Madame |
| Karlgren, Nils | Sommerschild, C. |
| Kelly, Sir Thomas (<i>President of the</i> | Sommerschild, Madame |
| <i>Institute of Accountants and Ac-</i> | Somerville, Mrs. J. L. |
| <i>tuaries in Glasgow</i>). | Stefănescu, S. |
| Latham, J. C. (<i>Secretary of the</i> | Strobel, J. P. |
| <i>London Association of Certified</i> | Strobel, Madame |
| <i>Accountants</i>). | Svata, Fraulein Vera |
| Lenares, Miss C. | Svensson, Seth |
| Løkkegaard, Capitaine C. F. | Täubert, Curt |
| Martin, René | Teply, Josef |
| Martin, Madame | Teply, Frau. |
| Mitchell, Miss M. E. | Tjus, Fritz |
| Murphy, Mrs. | Tjus, Madame |
| Myer, Dean J. C. | Upleger, A. C. |
| Parton, John | Upleger, Mrs. |
| Parton, Mrs. | Upleger, Miss |

GLASGOW

The Corporation of Accountants acted as joint-hosts with the Institute of Accountants and Actuaries in Glasgow during the visit of the delegates to the West of Scotland, the necessary arrangements being made by the respective secretaries, Mr. D. Norman Sloan, C.A., and Mr. J. Stirling Brown, C.R.A.

On Tuesday the 25th July the party proceeded to Glasgow, where they were received by the representatives of the Institute of Accountants and Actuaries in Glasgow and the Corporation of Accountants.

As soon as possible after their arrival the visitors were taken for a short motor drive round the city. There was no time to stop at places of interest, but as they proceeded they had a glimpse of the City Chambers, the Cathedral, the Royal Infirmary, the University, the Art Galleries, the Western Infirmary, and some of the shipyards.

Lunch was served in the Central Hotel, when Sir Thomas Kelly, as President of the Institute of Accountants and Actuaries in Glasgow, occupied the Chair, and, along with Mr. T. Herbert Hughes, President of the Corporation of Accountants, extended a very hearty welcome to the visitors.

In the afternoon the party toured the three lochs, proceeding to Tarbet, Loch Lomond, via the Stockiemuir Road and Balloch, and returning by Loch Long, the Gareloch and Helensburgh. Unfortunately the weather was somewhat unpropitious; but while the visitors were at Tarbet, where tea was served, there was a glimpse of sunshine and the rain ceased for the time being so that it was possible to move about freely and enjoy the surroundings.

On Wednesday the guests and friends had an opportunity of viewing the beauties of the Clyde and the grandeur of the Scottish Highlands. The Loch Eck tour is held to be one of the most beautiful tours in western Scotland. Crossing from Gourock to Kilmarnock the party travelled by special motor vehicles to the seat of the Duke of Argyll, Inveraray, passing through country steeped in the history of old Clan warfare. The party left Inveraray by turbine steamer and returned to Glasgow via Tighnabruich, the Kyles of Bute and Rothesay.

A Farewell Dinner was held in the evening in the Central Station Hotel. Mr. T. Herbert Hughes, President of the Corporation of Accountants, occupied the Chair. The Chairman proposed the following toasts: "The King," "Reigning Sovereigns and Presidents"; and Herr Melchior Schwann of Germany proposed the health of "The Ladies," which was

received with acclamation. Thereafter the Chairman bade farewell to the visitors, expressed the hope that their stay in the West of Scotland had been enjoyable and wished them God-speed on their homeward journey. On behalf of the visitors, the following delegates made short speeches expressive of their thanks and appreciation of all that had been done to make their stay in the West of Scotland pleasant: Herr Christian Sommerschild of Norway; Mons. Marc Barbut of France; Mons. le Dr. Drăgănescu Brates, and Mons. le Prof. G. L. Trancu Iasy of Roumania.

Sir Thomas Kelly, in bringing the dinner to a close, expressed the hope that the visitors had seen something of Scotland which would make them endeavour to come back again and explore all the beauties of which Scotland was so justly proud. A most interesting and enjoyable evening was brought to a close by the singing of "Auld Lang Syne."

LIST OF DELEGATES AND VISITORS TO GLASGOW

United States of America.

Mr. and Mrs. John Berg
Mr., Mrs. and Miss A. C. Upleger
Mr., Mrs. and Miss Rittenhouse
Mr., Mrs. and Miss Banks
Mr. and Mrs. G. S. Olive
Mr. E. H. Griswold.

Canada.

Mr. and Mrs. H. R. Clark
Mr., Mrs. and Miss Parton

Germany.

Herr Dr. Paul Schourp
Herr Melchior Schwoon
Herr G. Schultze
Fräulein Johanna Schmidt
Herr Hugo Grosz
Herr Dr. B. Penndorf
Herr Dr. G. F. Horn
Herr Hugo Grahl and Frau Eva Dietze
Herr Dr. W. Schiffmann
Herr C. Täubert
Herr Dr. W. Schneider

France.

Mons. and Madame Marc Barbut
Mons. and Madame Léon Retail
Mons. and Madame René Martin
Mons. and Madame Emile Buriat
Mons. René Bès de Berc

Roumania.

M. le Dr. and Madame Drăgănescu Brates
Mons. N. and Madame Butculescu
Mons. and Madame Arthur Holban
Mons. Simion Ștefănescu
Mons. le Prof. G. L. Trancu Iasy

Denmark.

Mons. and Madame Ove Breuner
Mons. and Madame C. Jespersen
Mons. and Madame J. P. Strobel
Mons. le Capitaine Løkkegaard

Norway.

Mons., and Madame C. Sommerschild
Mons. and Madame Paal Forberg

Sweden.

Mons. Tore Sjoaker
 Mons. Seth Svensson
 Mons. L. T. Bohlin and Mdlle.
 Bohlin
 Mons. and Madame Fritz Tjus
 Mons. Kurt Elfborg
 Mons. Nils Karlgren

Czechoslovakia.

Mons. Kamil Augsten
 Mons. Ing. J. Fuksa, Frau J.
 Fuksova-Svata and Fraulein
 Svata

Czechoslovakia.

Mons. Josef and Frau Teplý

Holland.

Mons. W. T. J. Abbema
 Mons. J. Pelser, Jr., and Madame
 A. Pelser-Groenevelt
 Mons. W. A. Hamelberg and
 Madame J. Hamelberg-Bosch
 Mons. G. P. J. Hogeweg
 Mons., Madame and Mdlle. Van
 Douwe
 Mons. le Drs. A. Robles

ABERDEEN

The party of the delegates and visitors from abroad travelled from Glasgow to Aberdeen on Thursday, the 27th July. On their arrival they were received by the President and Secretary of the Society of Accountants in Aberdeen.

On Friday some of the party visited the Fish Market, and were much impressed by the scenes of activity prevailing there in the early morning.

At 10 a.m. the party proceeded by motor to Braemar. The outward journey was along the south side of the River Dee as far as Ballater. There a halt was called for a short time, and thereafter the party proceeded along the north side of the River past Balmoral Castle and Invercauld House, to Braemar.

After luncheon in the Invercauld Arms Hotel, Mr. Herbert Bower, President of the Aberdeen Society, gave the toast of the King, and extended a very warm welcome to the guests. Colonel Farquharson of Invercauld, who was also present, gave a short account of some outstanding events connected with that part of Scotland, such as the raising of the Standard of the Jacobites "on the braes of Mar" in 1715. Colonel Farquharson's remarks were of great interest to the delegates.

Several of the delegates responded and expressed their admiration of the picturesque scenery of the Dee Valley, the pleasure enjoyed in visiting the North of Scotland, and their thanks for all the arrangements made for their entertainment. Among those who spoke were:—Mr. A. S. Banks (U.S.A.), Mons. René Martin (France), Herr Melchior Schwoon (Germany) and Mons. Ștefănescu (Roumania).

The return journey to Aberdeen in the afternoon was along the north side of the River. A halt was made at Tor-na-Coilhe Hotel, Banchory, where tea was served.

With the exception of a slight shower in the afternoon the weather was perfect, and the party had clear views of the higher mountains—Lochanagar and some of the Cairngorms.

The following were of the party :—

From U.S.A. :—Mr. and Mrs. John Berg, Mr. and Mrs. A. C. Upleger and daughter, Mr. and Mrs. C. F. Rittenhouse and daughter, Mr. and Mrs. A. S. Banks and daughter, Mr. and Mrs. H. E. Howell.

From France :—Mons. and Mme. Léon Retail, Mons. and Mme. René Martin, Mons. R. Bès de Berc, Mons. and Mme. E. Buriat.

From Germany :—Herr Melchior Schwoon, Herr Hugo Grahl, and Fräulein Wintermantel.

From Denmark :—Mons. and Mme. O. Breuner.

From Holland :—Mons. and Mme. J. Pelser, Jnr., Mons. and Mme. W. A. Hamelberg, Mons. and Mme. F. Rinsma, and Mons. G. P. J. Hogeweg.

From Sweden :—Mons. and Mme. Sjoaker, Mons. Seth Svensson, Mons. and Mme. Fritz Tjus, and Mons. K. Elfborg.

From Roumania :—Mons. le Dr. and Mme. Drăgănescu Brates, Mons. S. Stefănescu, and Mons. le Prof. G. L. Trancu Iasy

From Czechoslovakia :—Mons. K. Augsten.

From Italy :—Sig. F. Viscardi.

VISIT TO IRELAND

On the 24th and 25th July the Institute of Chartered Accountants in Ireland and the Irish Branch of the Society of Incorporated Accountants and Auditors entertained in Dublin the following guests who had attended the Fourth International Congress on Accounting in London—Mr. and Mrs. W. A. Appleton, New Zealand ; Mr. and Mrs. J. Hyde, Montreal ; Mr. Harold Jackson, Bucharest ; Mr. and Mrs. R. K. Hardy, London ; Mr. C. Van Uden, Amsterdam ; and Mr. A. J. Walker, Toronto.

On the 24th inst. the guests, accompanied by several members of the Institute and of the Society, and their wives, visited Trinity College, where they were shown the Library and the famous Book of Kells, the Chapel, Examination Hall, Hall of Honour (War Memorial), the Commons Dining Hall and the kitchens attached. The party then visited the Dail and Seanad, the Government Buildings, Dublin Castle, the Bank of Ireland in which the old Houses of Parliament were situate, and the principal Monuments of the City. After luncheon at the Hibernian Hotel, at which the Presidents of the Institute and of the Irish Branch of the Society extended a very cordial welcome to the visitors, the party made an extensive tour of Guinness's Brewery, and had afternoon tea in the Zoological Gardens, Phoenix Park, where they were received by Mrs. Geoghegan.

On the following day the party, accompanied by members of the Institute and the Society, proceeded by Luxury Bus to tour Co. Wicklow, including a visit to Glendalough and the Seven Churches. Luncheon was served at the Royal Hotel, Glendalough, and the tour continued to Greystones, where afternoon tea was served on the lawn of the Grand Hotel.

The visitors were favoured with splendid weather, and all of them expressed their keen enjoyment of the interesting features of Dublin and the delightful scenery of Co. Wicklow. With the exception of Mr. and Mrs. Hardy they left on Tuesday evening for Belfast, where they were met by representatives of the Belfast Society of Chartered Accountants, and of the Belfast and District Society of Incorporated Accountants, and conveyed to their hotel in motor cars.

On Wednesday, 26th July, they made a tour of the City, visiting the new Courts of Justice, the City Hall, and the Linen Manufacturing Works

of the York Street Flax Spinning Co., Ltd., where they saw the various processes in the manufacture of linen.

At the City Hall they were received by the Lord Mayor, who was accompanied by the Town Clerk and the City Treasurer. The Lord Mayor extended a hearty welcome to them, and expressed the hope that their visit to the North of Ireland would be enjoyable. He referred to the abounding hospitality and kindness which he had experienced when he visited Canada, and the delightful time he had had in Montreal and Toronto. Mr. Hyde and Mr. Walker, of Canada, replied in complimentary terms.

Subsequently the party were shown the principal apartments in the City Hall, and they expressed their appreciation of the building and of the courtesy extended to them. They were each supplied with a copy of the Corporation's Year Book as a souvenir of the visit.

The guests were entertained at luncheon in the Grand Central Hotel, where a representative number of Belfast accountants was present to meet them, and subsequently they inspected the new Parliament buildings and made a tour of County Down, embracing Newtownards, Greyabbey (where a stop was made to inspect the ruins of the abbey), Ballywalter, Donaghadee and Bangor. The journey was broken at Donaghadee, where tea was served at the Mount Royal Hotel.

On Thursday, 27th July, the party left by motor coach for a tour of County Antrim. They proceeded by way of Carrickfergus (with its historic Castle); Whitehead, and the shores of Larne Lough to the famous Antrim Coast Road, and Ballycastle, whence the great precipice of Fair Head was viewed. Lunch was partaken of at the Giant's Causeway Hotel, and inspection made of the world-famed Causeway itself, with its geological wonders. Proceeding by way of Dunluce Castle the party reached Portrush where a halt was made at the Northern Counties Hotel for afternoon tea, at the conclusion of which speeches of appreciation and thanks were made by the delegates, and responded to.

The return journey to Belfast was by way of Portstewart, Coleraine and Ballymena to Antrim, where a detour introduced the guests to Lough Neagh, the largest lake in the British Isles. Belfast was reached about 8 p.m. and the guests left for England the same evening.

The visit was greatly enjoyed by the hosts both in Dublin and Belfast, and the guests expressed their very warm appreciation of all that they had seen and of the hospitality extended to them during their stay in Ireland.

APPENDIX A

Westminster Abbey.

ORDER OF SERVICE

HYMN

ALL people that on earth do dwell,
Sing to the Lord with cheerful voice ;
Him serve with fear, His praise forth tell,
Come ye before Him, and rejoice.

The Lord, ye know, is God indeed ;
Without our aid He did us make ;
We are His folk, He doth us feed,
And for His sheep He doth us take.

O enter then His gates with praise,
Approach with joy His courts unto ;
Praise, laud, and bless His Name always,
For it is seemly so to do.

For why ? the Lord our God is good ;
His mercy is for ever sure ;
His truth at all times firmly stood,
And shall from age to age endure.

To Father, Son, and Holy Ghost,
The God Whom Heav'n and earth adore,
From men and from the Angel-host
Be praise and glory evermore. *Amen.*

Then the Dean will say :

WE are gathered together, Brethren, in this historic Church, surrounded by memorials of men who have served their generation faithfully in every department of our varied life, and helped to build up our manifold inheritance ; and we are here to witness to our belief in the providence and continuing love of Almighty God and to ask His blessing upon the counsels of those whose business in different parts of the world is for the welfare of men in their dealings one with another.

Let us pray

ALMIGHTY God, our heavenly Father, who of his great mercy hath promised forgiveness of sins to all them that with hearty repentance and true faith turn unto him ; Have mercy upon us ; pardon and deliver us from all our sins ; confirm and strengthen us in all goodness ; and bring us to everlasting life ; through Jesus Christ our Lord. *Amen.*

Let us pray for guidance

GRANT to us, Lord, we beseech thee, the spirit to think and do always such things as be rightful ; that we, who cannot do any thing that is good without thee, may by thee be enabled to live according to thy will ; through Jesus Christ our Lord. *Amen.*

OUR Father which art in heaven, Hallowed be thy Name, Thy kingdom come, Thy will be done, in earth as it is in heaven. Give us this day our daily bread ; And forgive us our trespasses, As we forgive them that trespass against us ; And lead us not into temptation, But deliver us from evil. For thine is the kingdom, the power, and the glory, For ever and ever. *Amen.*

Then, all standing, shall be sung ;

PSALM LXVII

Deus misereatur

GOD be merciful unto us, and bless us : and shew us the light of his countenance, and be merciful unto us :

That thy way may be known upon earth : thy saving health among all nations.

Let the people praise thee, O God : yea, let all the people praise thee.

O let the nations rejoice and be glad : for thou shalt judge the folk righteously, and govern the nations upon earth.

Let the people praise thee, O God : let all the people praise thee.

Then shall the earth bring forth her increase : and God, even our own God, shall give us his blessing.

God shall bless us : and all the ends of the world shall fear him.

Glory be to the Father, and to the Son : and to the Holy Ghost ;

As it was in the beginning, is now, and ever shall be : world without end. *Amen.*

After which will be read :

THE LESSON

ROMANS XII

I BESEECH you therefore, brethren, by the mercies of God, that ye present your bodies a living sacrifice, holy, acceptable unto God, which is your reasonable service. And be not conformed to this world : but be ye transformed by the renewing of your mind, that ye may prove what is that good, and acceptable, and perfect, will of God. For I say, through the grace given unto me, to every man that is among you, not to think of himself more highly than he ought to think ; but to think soberly, according as God hath dealt to every man the measure of faith. For as we have many members in one body, and all members have not the same office : So we, being many, are one body in Christ, and every one members one of another. Having then gifts differing according to the grace that is given to us, whether prophecy, let us prophesy according to the proportion of faith ; Or ministry, let us wait on our ministering : or he that teacheth, on teaching ; Or he that exhorteth, on exhortation : he that giveth, let him do it with simplicity ; he that ruleth, with diligence ; he that sheweth mercy, with cheerfulness. Let love be without dissimulation. Abhor that which is evil ; cleave to that which is good. Be kindly affectioned one to another with brotherly love ; in honour preferring one another ; Not slothful in business ; fervent in spirit ; serving the Lord ;

Rejoicing in hope; patient in tribulation; continuing instant in prayer; Distributing to the necessity of saints; given to hospitality. Bless them which persecute you: bless, and curse not. Rejoice with them that do rejoice, and weep with them that weep. Be of the same mind one toward another. Mind not high things, but condescend to men of low estate. Be not wise in your own conceits. Recompense to no man evil for evil. Provide things honest in the sight of all men. If it be possible, as much as lieth in you, live peaceably with all men. Dearly beloved, avenge not yourselves, but rather give place unto wrath: for it is written, Vengeance is mine; I will repay, saith the Lord. Therefore if thine enemy hunger, feed him; if he thirst, give him drink: for in so doing thou shalt heap coals of fire on his head. Be not overcome of evil, but overcome evil with good.

TE DEUM LAUDAMUS

WE praise thee, O God: we acknowledge thee to be the Lord.
 All the earth doth worship thee: the Father everlasting.
 To thee all Angels cry aloud: the heavens and all the powers therein.
 To thee Cherubin and Seraphin: continually do cry,
 Holy, Holy, Holy: Lord God of Sabaoth;
 Heaven and earth are full of the Majesty: of thy glory.
 The glorious company of the Apostles: praise thee.
 The goodly fellowship of the Prophets: praise thee.
 The noble army of Martyrs: praise thee.
 The holy Church throughout all the world: doth acknowledge thee;
 The Father: of an infinite Majesty;
 Thine honourable, true: and only Son;
 Also the Holy Ghost: the Comforter.
 Thou art the King of glory: O Christ.
 Thou art the everlasting Son: of the Father.
 When thou tookest upon thee to deliver man: thou didst not abhor the Virgin's womb.
 When thou hadst overcome the sharpness of death: thou didst open the kingdom of heaven to all believers.
 Thou sittest at the right hand of God: in the glory of the Father.,
 We believe that thou shalt come: to be our Judge.
 We therefore pray thee, help thy servants: whom thou hast redeemed with thy precious blood.
 Make them to be numbered with thy Saints: in glory everlasting.

Then the Precentor will say:

The Lord be with you

And with thy spirit

Let us pray for the coming of God's kingdom upon earth.

O GOD, who hast taught us to live in the cities of this world as knowing our citizenship to be in heaven; guide we pray thee, with thy heavenly wisdom, all who are in positions of responsibility and authority; that they may keep ever before their eyes the vision of the heavenly kingdom; for the sake of Jesus Christ our Lord. *Amen.*

ALMIGHTY God, from whom all thoughts of truth and peace proceed, inspire we pray thee the hearts of all men with the true love of peace, and guide with thy wisdom those who take counsel for the nations of the world, that all men may learn to dwell together as brothers and live at peace, for the sake of Jesus Christ our Lord. *Amen.*

· **A**LMIGHTY and everlasting God, who in thy providence dost guide the histories of nations, and whose will it is to gather all into the kingdom of thy Son, Jesus Christ, grant that nothing may hinder the contribution of each nation to the truth and the civilisation of the world, and that the way may be made plain for all peoples so to be joined together that they may apprehend the fulness of thy revelation, and may increase in common understanding, through the same thy Son, Jesus Christ. *Amen.*

ANTHEM

GOD is a Spirit ; and they that worship Him must worship Him in spirit and in truth. For the Father seeketh such to worship Him.
(*Sterndale Bennett.*)

SERMON BY

HIS GRACE THE LORD ARCHBISHOP OF YORK.

HYMN

THY kingdom come, O God,
Thy rule, O Christ, begin :
Break with Thine iron rod
The tyrannies of sin.

Where is Thy reign of peace,
And purity, and love ?
When shall all hatred cease,
As in the realms above ?

When comes the promised time
That war shall be no more,
And lust, oppression, crime
Shall flee Thy Face before ?

We pray Thee, Lord, arise,
And come in Thy great might ;
Revive our longing eyes,
Which languish for Thy sight.

Men scorn Thy sacred Name,
And wolves devour Thy fold ;
By many deeds of shame
We learn that love grows cold.

O'er heathen lands afar
Thick darkness broodeth yet :
Arise, O morning Star,
Arise, and never set.

Let us pray

THY kingdom come, O God, on earth as it is in heaven. That we and all the peoples of the world may be set free from suspicion, mistrust, and fear, and may work together for the glory of God and for the welfare of mankind.

Thy kingdom come, O God, on earth as it is in heaven. That we and all mankind may be filled with the spirit of brotherhood, service, and love.

Thy kingdom come, O God, on earth as it is in heaven. That there may be increased in us the neighbourly spirit in all the common ways of life.

Thy kingdom come on earth, O Lord God, that we may have grace to take no rest until thy peace is found here as it is in heaven. Through Jesus Christ our Lord. *Amen.*

Let us say, all together : .

ALMIGHTY God, Father of all mercies, we thine unworthy servants do give thee most humble and hearty thanks for all thy goodness and loving-kindness to us and to all men ; We bless thee for our creation, preservation, and all the blessings of this life ; but above all for thine, inestimable love in the redemption of the world by our Lord Jesus Christ, for the means of grace, and for the hope of glory. And we beseech thee, give us that due sense of all thy mercies, that our hearts may be unfeignedly thankful, and that we shew forth thy praise, not only with our lips, but in our lives ; by giving up ourselves to thy service, and by walking before thee in holiness and righteousness all our days ; through Jesus Christ our Lord, to whom with thee and the Holy Ghost be all honour and glory, world without end. *Amen.*

The Dean will then pronounce THE BLESSING in the following words :—

GO forth into the world in peace ; be of good courage ; hold fast that which is good ; strengthen the faint-hearted ; support the weak ; help the afflicted ; honour all men ; love and serve the Lord, rejoicing in the power of the Holy Spirit. And the blessing of God Almighty, Father, Son and Holy Spirit be upon you and remain with you for ever. *Amen.*

APPENDIX B

BANQUET IN GUILDHALL

19TH JULY, 1933

MENU

Wines

Tortue Claire

PUNCH

Birch's

Filets de Sole Chablis

SHERRY

Domecq's

Vol au Vent de Ris de Veau

DRY GRAVES

Château du Roi

Baron of Beef

Baked Potatoes

CHAMPAGNE

Pommery 1921

Clicquot 1923

Caneton Rôti

Petits Pois

Passiflore Glacée

PORT

Offley 1910

Gaufrettes au Citron

CLARET

Château Lafitte 1918

Dessert

LIQUEUR BRANDY

Café

TOAST LIST

THE KING

Proposed by The President.

HER MAJESTY THE QUEEN

HIS ROYAL HIGHNESS THE PRINCE OF WALES

AND OTHER MEMBERS OF THE ROYAL FAMILY

Proposed by The President.

THE FOURTH INTERNATIONAL CONGRESS ON ACCOUNTING

Proposed by H.R.H. The Prince George,
K.G.

Responded to by The President.
Colonel R. H. Montgomery, C.P.A.

THE GUESTS

Proposed by The Vice-President.

Responded to by . . . His Grace The Archbishop of York, P.C.
Mons. E. Van Dien.

THE CHAIRMAN

Proposed by . . . The Marquis of Reading, P.C., G.C.B., G.C.S.I.,
G.C.I.E., G.C.V.O.,

Responded to by The President.

PROGRAMME OF MUSIC

- | | | |
|--------------------------------|--|------------------|
| 1. MARCH | " The Last Stand " | <i>Myddleton</i> |
| 2. OVERTURE | " Light Cavalry " | <i>Suppé</i> |
| 3. VALSE | " Unrequited Love " | <i>Lincke</i> |
| 4. SELECTION | " The Gondoliers " | <i>Sullivan</i> |
| 5. BARCAROLLE | " Les Contes d'Hoffmann " | <i>Offenbach</i> |
| 6. SUITE | " Three Light Pieces " | <i>Fletcher</i> |
| 7. VALSE | " Blue Danube " | <i>Strauss</i> |
| 8. SELECTION | " The Merry Widow " | <i>Lehar</i> |
| 9. CHARACTERISTIC | " The Parade of the Tin Soldiers " | <i>Jessel</i> |
| 10. SUITE DE BALLET | " Egyptien " | <i>Luigini</i> |
| 11. SPANISH SERENADE | " La Palome " | <i>Yradier</i> |
| 12. SELECTION | " A Country Girl " | <i>Monckton</i> |
| 13. INTERMEZZO | " Manuella " | <i>Lotter</i> |
| 14. THREE DANCES | " Nell Gwyn " | <i>German</i> |

MUSICIANS OF THE BAND OF HIS MAJESTY'S SCOTS GUARDS

By kind permission of

Colonel E. C. T. Warner, D.S.O., M.C., Lieut.-Colonel Commanding Scots
Guards

Conducted by

Director of Music—LIEUT. HORACE E. DOWELL, L.R.A.M., p.s.m., Scots
Guards

INDEX OF GUESTS.

- Prince George, His Royal Highness The, K.G.
- A
- Abbema, Monsieur W. T. J. (*Holland*)
 Adgie, Mr. William, F.C.A.
 Alatrister, Señor Roberto Casas, C.P.T. (*Mexico*)
 Alexander, Mr. J. R. W.
 Alexander, Mr. S. W. (*City Editor, The "Daily Express"*)
 Allan, Mr. D. H., C.A.
 Allan, Mr. R. J., A.C.A.
 Allen, Sir Hugh, K.C.V.O. (*Director, The Royal College of Music*)
 Allenby, Field-Marshal The Viscount, G.C.B., G.C.M.G.
 Allison, Mr. T. B., C.A.
 Andersen, Monsieur Helge (*Denmark*)
 Anderson, Sir Alan, K.B.E. (*President, The Associated Chambers of Commerce*)
 Anderson, Col William, D.S.O., M.C. (*President, The Auctioneers' and Estate Agents' Institute*)
 Andrewes-Uthwatt, Mr. A.
 Annan, Professor W., C.A.
 Appleton, Mr. Will, F.R.A. (*New Zealand*)
 Archibold, Mr. A. W., F.C.R.A., A.I.S.A.
 Arnold, The Lord
 Ashworth, Mr. Robert, F.C.A., F.S.A.A.
 Askwith, The Lord, K.C.B. (*President, The Institute of Arbitrators*)
 Attewell, Mr. W. S., F.C.R.A.
 Augsten, Monsieur Kamil (*Czechoslovakia*)
 Austin, Sir Herbert, K.B.E.
- B
- Back, Mr. W. J., A.S.A.A.
 Bailey, Mr. F. W., F.C.A.
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 Baldry, Mr. E., F.S.A.A.
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 Barbut, Monsieur Marc (*France*)
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- Barrett, Mr. R. J. (*City Editor, The "Financial Times"*)
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 Bennett, The Hon. Mr Justice (Mil.), T.D., C.A.
 Benzie, Mr. Robert Marr, O.B.E.
 Berg, Mr. John, M.C.S., C.P.A. (*America*)
 Berger, Mr. S. J. D., M.C.
 Bès de Bérc, Monsieur René (*France*)
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 Bowater, Sir Vansittart, Bt., M.P.
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 tary, The Joint Committee of Coun-
 cils, Chartered Accountants of Scot-
 land*)
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 G.C.I.E., C.B.E.
 Goschen, The Hon. Sir William, K.B.E.
 Goskar, Mr. A. E., F.S.A.A.
 Grace, Mr. Stephenson, F.C.A.
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 Graham-Campbell, Sir Rollo F. (*Chief
 Metropolitan Magistrate*)
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 (*Treasurer, Gray's Inn*)
 Greenhill, Mr. William, C.A.
 Greening, Mr. H. J. (*President, The
 Chartered Insurance Institute*)
 Grenfell, Mr. E. C., M.P.
 Grey, The Hon. David L. (*America*)
 Grigg, Sir James, K.C.B. (*Chairman,
 The Board of Inland Revenue*)
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 Minister for Finland*)
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 (*America*)
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 Gundry, Mr. Richard, F.C.R.A.,
 F.I.S.A.

H

- Haanes, Herr Kapitan K. (*Norway*)
 Haines, Mr. G. C., A.C.A.
 Haines, Mr. H. C., F.C.A.
 Halsbury, The Earl of, K.C.
 Halsey-Bircham, Sir Bernard, K.C.V.O.
 Hamelberg, Monsieur K. A. (*Holland*)
 Hannaford, Mr. J., A.C.A.
 Hannah, Mr. Alexander, F.S.A.A.
 Hansell, Sir William, K.C. (*Treasurer,
 The Inner Temple*)
 Hanson, Mr. E. H., A.C.A.
 Hard, Mr. Edwin, F.C.A.
 Harding, Sir Edward J., K.C.M.G.,
 C.B. (*Permanent Under Secretary,
 The Dominions Office*)
 Hardy, Mr. R. K., F.C.P.A.
 Harris, Mr. W. F., F.C.A.
 Harwood, Sir Ralph, K.C.V.O., C.B.,
 C.B.E. (*Deputy-Treasurer, The King*)
 Haskell, Mr. M. Ogden, C.A. (*Canada*)
 Hastings, Sir Patrick, K.C.
 Hatfield, Professor Henry Rand, Ph.D.
 (*America*)
 Haworth, Mr. T., F.S.A.A.
 Hay, Mr. David Allan, O.B.E., C.A.
 Hayes, Mr. Thomas, F.S.A.A.
 Headlam, Mr. Maurice F., C.B.,
 C.M.G. (*Comptroller-General, National
 Debt Office*)
 Heenan, Commander V. Hammersley,
 R.N.
 Hemphill, Mr. Robert, C.A. (*Edinburgh
 and South Africa*)
 Hewson, Mr. C. A. G., A.S.A.A.
 Hill, Mr. Ernest, F.C.R.A., A.S.A.A.
 Hill, Mr. H. L. H., F.C.A. (*President,
 The Institute of Chartered Accountants
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 Hillyer, Mr. Arthur H., F.C.A.
 Hillyer, Mr. S. G., O.B.E., F.C.A.
 Himmelblau, Professor David, C.P.A.
 (*America*)
 Hinnen, Monsieur G. K. H. (*Holland*)
 Hobson, Mr. O. R. (*City Editor, The
 "Financial News"*)
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 Holban, Mr. Arthur (*Roumania*)
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L

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T

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U

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Y

- York, His Grace the Archbishop of
 ———
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